

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 534

ESTATE OF HENRY W. PUTNAM; GUARANTY
TRUST COMPANY OF NEW YORK, EXECUTOR,
PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE SECOND CIRCUIT

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[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 102689

ESTATE OF HENRY W. PUTNAM, Deceased, GUARANTY TRUST
COMPANY OF NEW YORK, Executor, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances:

For Taxpayer: Carl A. deGersdorff, Esq., William H.
Gambrell, Esq., James H. Nichols, Esq.

For Comm'r.: L. A. Spaulding, Esq.

DOCKET ENTRIES

1940

- May 16. Petition received and filed. Taxpayer notified.
Fee paid.
- May 16. Request for Circuit hearing in New York City
filed by taxpayer. 5/17/40 copy served.
- May 17. Copy of petition served on General Counsel.
- Jul. 6. Answer filed by General Counsel.
- Jul. 12. Copy of answer served on taxpayer. New York
calendar.

1941

- Feb. 5. Hearing set March 31, 1941 in New York City.
- Mar. 31. Hearing had before Mr. Kern. Submitted. Dock-
ets 102689 & 90 consolidated. Stipulation of
facts filed. Briefs due as per rules.

[fol. 2]

- Apr. 12. Transcript of hearing of March 31, 1941 filed.
- May 15. Brief filed by taxpayer.
- May 15. Motion for extension of 30 days to file brief filed
by General Counsel. 5/16/41 granted.
- Jun. 14. Motion for extension to June 25, 1941 to file brief
filed by General Counsel. 6/16/41 granted.
- Jun. 25. Brief filed by General Counsel.
- Jun. 26. Copy of brief served on General Counsel.
- Jul. 9. Reply brief filed by General Counsel.

1941

- Oct. 28. Findings of fact and opinion rendered, Kern, Div. 16. Decision will be entered under Rule 50. 10/28/41 copy served.
- Nov. 24. Agreed computation of deficiency filed.
- Nov. 25. Decision entered, Kern, Div. 16.

1942

- Feb. 18. Petition for review by U. S. Circuit Court of Appeals, Second Circuit, with assignments of error filed by General Counsel.
- Feb. 23. Proof of service filed by General Counsel. (2)
- Feb. 25. Petition for review by U. S. Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.
- Feb. 25. Proof of service filed by taxpayer.
- Mar. 9. Agreed praecipe for record filed. (Both causes.)
- Mar. 13. Certified copy of order from the 2nd Circuit consolidating causes for briefing, hearing, argument and decision upon a single consolidated transcript of record filed. (Both causes.)

[fol. 3] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 102690

[Same title]

Appearances:

For Taxpayer: Carl A. deGersdorff, Esq., William H. Gambrell, Esq., James H. Nichols, Esq.

For Comm'r.: L. A. Spaulding, Esq.

DOCKET ENTRIES

1940

- May 16. Petition received and filed. Taxpayer notified. Fee paid.
- May 16. Request for Circuit hearing in New York City filed by taxpayer. 5/17/40 copy served.
- May 17. Copy of petition served on General Counsel.
- Jul. 6. Answer filed by General Counsel.

1940

- Jul. 12. Copy of answer served on taxpayer. New York calendar.

1941

- Feb. 5. Hearing set March 31, 1941 in New York City.
 Mar. 31. Hearing had before Mr. Kern. Submitted. Dockets 102689 & 90 consolidated. Stipulation of facts filed. Briefs due as per rules.
 Apr. 12. Transcript of hearing of March 31, 1941 filed.
 May 15. Brief filed by taxpayer.
 May 15. Motion for extension of 30 days to file brief filed by General Counsel. 5/16/41 granted.

[fol. 4]

- Jun. 14. Motion for extension to June 25, 1941 to file brief filed by General Counsel. 6/16/41 granted.
 Jun. 25. Brief filed by General Counsel.
 Jun. 26. Copy of brief served on General Counsel.
 Jul. 9. Reply brief filed by General Counsel.
 Oct. 28. Findings of fact and opinion rendered, Kern, Div. 16. Decision will be entered under Rule 50. 10/28/41 copy served.
 Nov. 26. Agreed computation of deficiency filed.
 Nov. 27. Decision entered, Kern, Div. 16.

1942

- Feb. 18. Petition for review by U. S. Circuit Court of Appeals, Second Circuit, with assignments of error filed by General Counsel.
 Feb. 23. Proof of service filed by General Counsel. (2)
 Feb. 25. Petition for review by U. S. Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.
 Feb. 25. Proof of service filed by taxpayer.
 Mar. 9. Agreed praecipe for record filed. (Both causes.)
 Mar. 13. Certified copy of order from the 2nd Circuit consolidating causes for briefing, hearing, argument and decision upon a single consolidated transcript of record filed. (Both causes.)

[fol. 5] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 102689

[Same title]

PETITION—Filed May 16, 1940

The above-named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (SN-IT-1; LAL-90 D) dated March 6, 1940, and as a basis of its proceeding alleges as follows:

1. The petitioner is a fiduciary with its principal office at No. 140 Broadway, in the Borough of Manhattan, City and State of New York. Henry W. Putnam was an individual with his residence at the Savoy-Plaza Hotel, Fifth Avenue and 59th Street, in said Borough of Manhattan. Said Henry W. Putnam died on March 30, 1938. Guaranty Trust Company of New York is a corporation incorporated under the laws of the State of New York, having its principal office and place of business at No. 140 Broadway, in said Borough of Manhattan. Said Guaranty Trust Company of New York qualified as Executor of the Estate of said Henry W. Putnam, deceased, in the Surrogates' Court of the County of New York on June 16, 1938, and is still qualified and acting as such Executor. The return for the period here involved was filed with the Collector of Internal Revenue for the Second District of New York, at the Custom House, New York, New York.

[fol. 6] *2.* The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on March 6, 1940.

3.* The taxes in controversy are the income taxes of the Estate of said decedent for the calendar year 1938. The deficiency asserted is \$2,658.64, the entire amount of which is in controversy. The petitioner asks a refund in the amount of \$41.12. The aggregate amount in controversy is accordingly \$2,699.76.

4.* The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in refusing to exclude from gross income of the Estate of said decedent re-

ported in the income tax return which was filed for the Estate for the calendar year 1938 the amount of \$2,400 which was not the income of the Estate.

(b) The Commissioner erred in adding to the gross income of the Estate of said decedent reported in the income tax return which was filed for the Estate for the calendar year 1938 the amount of \$21,651.75 which was not the income of the Estate.

5.* The facts upon which the Petitioner relies as the basis of this proceeding are as follows:

[fol. 7] (a) Said Henry W. Putnam died on March 30, 1938.

(b) Said decedent at the date of his death owned 4,800 shares of Common Stock of The American Smelting & Refining Company, a New Jersey Corporation. A dividend of \$2,400 (50 cents per share) on said stock was declared on March 1, 1938, payable on May 31, 1938, to stockholders of record on May 6, 1938.

(c) Said dividend was included in the income tax return for 1938 which was filed for the Estate of said decedent.

(d) Said dividend was income of said decedent rather than income of the Estate of said decedent.

(e) In addition to the dividend described in (b) above, the Commissioner has included in the income of the Estate

* The petitioner believes that the notice of deficiency is correct. However, the Commissioner has taken inconsistent positions with respect to the inclusion of dividends declared before the date of death, the record date of which were after the date of death, holding such dividends taxable in *both* the income of the Estate and the income of the decedent in order to protect the interests of the Government. Accordingly the petitioner also has taken inconsistent positions in this petition and in the petition filed concurrently herewith with respect to the 1938 income tax of the decedent in order to protect the interests of the Estate. It is requested that the two cases be considered and decided together.

of said decedent for 1938 the following dividends on stocks owned by said decedent at the date of his death, which dividends were declared before the date of death, but the record dates of which were after the date of death:

Dividend of \$1.25 per share on 1,255 shares General Motors Corporation (a Delaware corporation) \$5 Preferred Stock, declared on February 7, 1938, payable on May 2, 1938, to stockholders of record on April 4, 1938	\$1,568.75
Dividend of 50¢ per share on 50 shares United Profit Sharing Corporation (a Delaware corporation) Preferred Stock, declared on February 24, 1938, payable on April 30, 1938, to stockholders of record on March 31, 1938	25.00
Dividends of 25¢ per share on 1,100 shares Westinghouse Air Brake Manufacturing Company [fol. 8] (a Pennsylvania corporation) Common Stock, declared on November 16, 1937, payable on April 30, 1938, July 30, 1938, and October 31, 1938, to stockholders of record on March 31, 1938, June 30, 1938 and September 30, 1938, respectively	825.00
Carried Forward	\$2,418.75
Brought forward	\$2,418.75
Dividend of 15¢ per share on 2,000 shares Hecker Products Corporation (a New Jersey corporation) Common Stock, declared on March 23, 1938, payable on May 2, 1938, to stockholders of record on April 9, 1938	300.00
Dividend of 20¢ per share on 290 shares Philadelphia Company (a Pennsylvania corporation) Common Stock, declared on March 18, 1938, payable on April 25, 1938, to stockholders of record on April 1, 1938	58.00
Dividend of 87½¢ per share on 1,000 shares United States Smelting, Refining & Mining Company (a Maine corporation) 7% Preferred Stock, declared on March 23, 1938, payable on April 15, 1938, to stockholders of record on April 1, 1938	875.00

Dividend of \$1 per share on 18,000 shares American Can Company (a New Jersey corporation) Common Stock, declared on March 29, 1938, payable on May 16, 1938, to stock- holders of record on April 25, 1938	18,000.00
Total	<u>\$21,651.75</u>

[fol. 9] (f) Said dividends were income of said decedent rather than income of the Estate of said decedent.

Wherefore the petitioner prays that this Board may hear the proceeding, redetermine the tax liability of the petitioner on account of the income tax of the Estate of said decedent for the calendar year 1938, determine that there is no deficiency in the income tax due from the petitioner on account of the income of the Estate of said decedent for the calendar year 1938, and that there is a refund of income tax due to the petitioner on account of the income of the Estate of said decedent for the calendar year 1938, in the amount of \$41.12, and grant such other and further relief as to the Board may seem proper.

Estate of Henry W. Putnam, Deceased, Guaranty Trust Company of New York, Executor, by A. W. LeGassick, Petitioner, Assistant Trust Officer; Carl A. de Gersdorff, William H. Gambrell, James H. Nichols, Counsel for Petitioner, 15 Broad Street, New York, New York.

[fol. 10] *Duly sworn to by A. W. Le Gassick. Jurat omitted in printing.*

[fol. 11] EXHIBIT "A" ANNEXED TO PETITION

Treasury Department

Internal Revenue Service

SN-IT-1

Mar. 6, 1940.

Office of Internal Revenue Agent in Charge 2d New York
Division. Estate of Henry W. Putnam, Deceased, Guar-
anty Trust Company of New York, Executor, 140 Broad-
way, New York, New York.

SIRS:

You are advised that the determination of your income tax liability for the taxable years ended Dec. 31, 1938 discloses a deficiency of \$2,658.64, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Revenue Agent in Charge, 90 Church Street, New York, New York, for the attention of LAL-90D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest [fol. 12] period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner,
by (Signed) C. R. Krigbaum, Internal Revenue
Agent in Charge.

Enclosures: Statement. Form of Waiver.

LAL:mlm.

Statement

Estate of Henry W. Putnam, Deceased, Guaranty Trust Company of New York, Executor, 140 Broadway, New York, New York.

Tax Liability for Taxable Year Ended
December 31, 1938

	<i>Liability</i>	<i>Assessed</i>	<i>Deficiency</i>
Income tax	\$2,699.76	\$41.12	\$2,658.64

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated August 16, 1939; to your protest dated October 17, 1939; and to the statements made at the conferences held on November 6, 1939, and January 31, 1940.

[fol. 13] A copy of this letter and statement has been mailed to your representative, Mr. William H. Gambrell, 15 Broad Street, New York, New York in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

Adjustment to Net Income

Net income as disclosed by return	\$2,027.78
Unallowable deduction and additional income	
(a) Dividends	22,209.17
Net income adjusted	<u>\$24,236.95</u>

Explanation of Adjustment

(a) Dividend income reported in amount of \$240,766.58 is increased \$22,209.17 by reason of the following:

1. The Bureau holds that Kennecott Copper Corporation dividends received in the year 1938 are taxable in their entirety. Accordingly, the amount of \$557.42 of a total of \$1,200.00 received from the aforesaid source, deemed by you to be nontaxable and omitted on your return, is included in gross income.

2. In order to protect the interests of the Government, dividends of \$21,651.75 declared prior to the date of death, payable to the stockholders of record on dates

after the date of death, have been included as income for the period after death.

[fol. 14]

Recapitulation

1.	\$557.42
2.	21,651.75
	<hr/>
Total	\$22,209.17

Computation of Tax
Revenue Act of 1938

Net income adjusted	\$24,236.95
Less: Personal exemption	1,000.00
	<hr/>
Balance (surtax net income)	\$23,236.95
Net income subject to normal tax	\$23,236.95
Normal tax at 4% on \$23,236.95	\$929.48
Surtax on \$23,236.95	1,770.28
	<hr/>
Total tax	\$2,699.76
Correct income tax liability	\$2,699.76
Income tax assessed:	
Original, Account No. 190456	41.12
	<hr/>
Deficiency of income tax	\$2,658.64
LAL:mlm.	

[fol. 15] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 102689

[Same title]

ANSWER—Filed July 6, 1940

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and in answer to the petition filed herein, admits, denies and avers as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.

3. Denies that the taxes in controversy are income taxes of the decedent for the calendar year 1938, and avers that while the notice of deficiency on its face appears to be a notice of deficiency for the calendar year 1938, a reading of the said notice reveals that it is a notice of deficiency for the period beginning March 31, 1938, and ending December 31, 1938. Denies the remaining allegations contained in paragraph 3 of the petition.

4. Denies that the Commissioner erred as alleged in subparagraphs (a) and (b) of paragraph 4 of the petition. Denies the allegations of fact contained in said subparagraphs. (The deficiency notice from which this appeal is taken was sent to the petitioner in order to protect the interest of the Government in the event that the appeal in [fol. 16] Docket No. 102690 should be decided adversely to the respondent. This denial, together with the subsequent denials appearing in this answer, are entered for the purpose of protecting the interest of the Government in the event an adverse decision should be rendered in Docket No. 102690 in order to present to the Board the issue of whether certain items of income should be included in the income of the decedent for the period beginning January 1, 1938 and ending March 31, 1938, or should be included in income of the estate of the decedent for the period beginning March 31, 1938, and ending December 31, 1938.)

5(a) (b). Admits the allegations contained in subparagraphs (a) and (b) of paragraph 5 of the petition.

5(c) Admits that the said dividend was included in the income tax return filed by the petitioner for the period beginning March 31, 1938 and ending December 31, 1938. Denies the remaining allegations contained in subparagraph (c) of paragraph 5 of the petition.

5(d). Denies the allegations contained in subparagraph (d) of paragraph 5 of the petition.

5(e). Admits that in addition to the dividends described in subparagraph (d) of the petition, Commissioner has included in the income of the said decedent for the period beginning March 31, 1938 and ending December 31, 1938, the dividend on stock owned by the said decedent at the date of his death, which dividend was declared before the date of death but was payable as set forth in subparagraph (e) of

paragraph 5 of the petition. Denies the remaining allegations contained in subparagraph (e) of paragraph 5 of the petition.

[fol.17] 5(f). Denies the allegations contained in subparagraph (f) of paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinabove admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved and the appeal denied.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: E. O. Hanson, Division Counsel; Leonard A. Spalding, Jr., Special Attorney, Bureau of Internal Revenue.

[fol.18] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 102690

[Same title]

PETITION—Filed May 16, 1940

The above-named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LAL-90 D) dated March 6, 1940, and as a basis of its proceeding alleges as follows:

1. The petitioner is a fiduciary with its principal office at No. 140 Broadway, in the Borough of Manhattan, City and State of New York. Henry W. Putnam was an individual with his residence at the Savoy-Plaza Hotel, Fifth Avenue and 59th Street, in said Borough of Manhattan. Said Henry W. Putnam died on March 30, 1938. Guaranty Trust Company of New York is a corporation incorporated under the laws of the State of New York, having its principal office and place of business at No. 140 Broadway, in said Borough of Manhattan. Said Guaranty Trust Company of New York qualified as Executor of the Estate of said Henry W. Putnam, deceased, in the Surrogates' Court of the County of New York on June 16, 1938, and is still

qualified and acting as such Executor. The return for the period here involved was filed with the Collector of Internal Revenue for the Second District of New York, at the Custom House, New York, New York.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on March 6, 1940.

[fol. 19] 3. The taxes in controversy are the income taxes of said decedent for the calendar year 1938 (during which calendar year said decedent died on March 30, 1938). The deficiency asserted is \$1,509.13, the entire amount of which is in controversy. The petitioner asks a refund in the amount of \$13,576.95. The aggregate amount in controversy is accordingly \$15,086.08.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in adding to the gross income of said decedent reported in the income tax return which was filed for him for the calendar year 1938 the amount of \$2,400 which was not the income of said decedent.

(b) The Commissioner erred in refusing to exclude from the gross income of said decedent reported in the income tax return which was filed for him for the calendar year 1938 the amount of \$21,651.75 which was not the income of said decedent.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Said Henry W. Putnam died on March 30, 1938.

(b) Said decedent at the date of his death owned 4,800 shares of Common Stock of The American Smelting & Refining Company, a New Jersey corporation. A dividend of \$2,400 (50 cents per share) on said stock was declared on March 1, 1938, payable on May 31, 1938, to stockholders of record on May 6, 1938.

[fol. 20] (c) Said dividend was not included in the income tax return for 1938 which was filed for said decedent. The Commissioner included said dividend in the income of said decedent for 1938 as income accrued

at the date of his death under Section 42 of the Revenue Act of 1938.

(d) Said dividend was income of the estate of said decedent rather than income of said decedent.

(e) In addition to the dividend described in (b) above, there were included in the income tax return for 1938 which was filed for said decedent the following dividends on stocks owned by said decedent at the date of his death, which dividends were declared before the date of death, but the record dates of which were after the date of death:

Dividend of \$1.25 per share on 1,255 shares General Motors Corporation (a Delaware corporation) \$5 preferred Stock, declared on February 7, 1938, payable on May 2, 1938, to stockholders of record on April 4, 1938	\$ 1,568.75
Dividend of 50¢ per share on 50 shares United Profit Sharing Corporation (a Delaware corporation) Preferred Stock, declared on February 24, 1938, payable on April 30, 1938, to stockholders of record on March 31, 1938	25.00
Dividends of 25¢ per share on 1,100 shares Westinghouse Air Brake Manufacturing Company (a Pennsylvania corporation) Common Stock, declared on November 16, 1937, [fol. 21] payable on April 30, 1938, July 30, 1938, and October 31, 1938, to stockholders of record on March 31, 1938, June 30, 1938 and September 30, 1938, respectively	825.00
Dividend of 15¢ per share on 2,000 shares Hecker Products Corporation (a New Jersey corporation) Common Stock, declared on March 23, 1938, payable on May 2, 1938, to stockholders of record on April 9, 1938	300.00
Dividend of 20¢ per share on 290 shares Philadelphia Company (a Pennsylvania corporation) Common Stock, declared on March 18, 1938, payable on April 25, 1938, to stockholders of record on April 1, 1938	58.00
Carried forward	\$ 2,776.75

Brought forward \$ 2,776.75

Dividend of 87½¢ per share on 1,000 shares
United States Smelting, Refining & Mining
Company (a Maine corporation) 7% Preferred Stock, declared on March 23, 1938,
payable on April 15, 1938, to stockholders of
record on April 1, 1938 875.00

Dividend of \$1 per share on 18,000 shares
American Can Company (a New Jersey corporation) Common Stock, declared on March
29, 1938, payable on May 16, 1938, to stock-
holders of record on April 25, 1938 18,000.00

Total \$21,651.75

[fol. 22] (f) The Commissioner refused to exclude said dividends from the income of said decedent for 1938 on the ground that said dividends were income accrued at the date of his death under Sec. 42 of the Revenue Act of 1938.

(g) Said dividends were income of the estate of said decedent rather than income of said decedent.

Wherefore the Petitioner Prays that this Board may hear the proceeding, redetermine the tax liability of the petitioner on account of the income tax of said decedent for the calendar year 1938, determine that there is no deficiency in the income tax due from the petitioner on account of the income of said decedent for the calendar year 1938, and that there is a refund of income tax due to the petitioner on account of the income of said decedent for the calendar year 1938 in the amount of \$13,576.95, and grant such other and further relief as to the Board may seem proper.

Estate of Henry W. Putnam, Deceased, Guaranty
Trust Company of New York, Executor, by
(Signed) A. W. LeGassick, Assistant Trust Officer,
Petitioner; Carl A. de Gersdorff, William H. Gambrell, James H. Nichols, Counsel for Petitioner,
15 Broad Street, New York, New York.

[fol. 23] *Duly sworn to by A. W. LeGassick. Jurat omitted in printing.*

[fol. 24] EXHIBIT "A" ANNEXED TO PETITION

Treasury Department
Internal Revenue Service
New York, N. Y.

Mar. 6, 1940.

Office of Internal Revenue Agent in Charge, Room 1120,
Federal Office Building, Church and Vesey Streets, 2d
New York Division.

Estate of Henry W. Putnam, Deceased, Guaranty Trust
Company of New York, Executor, 140 Broadway, New
York, New York.

SIRS:

You are advised that the determination of the income tax liability of Henry W. Putnam, deceased, for the taxable year ended December 31, 1938, discloses a deficiency of \$1,509.13, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Revenue Agent in Charge, 90 Church Street, New York, N. Y., for [fol. 25] the attention of LAL-90D. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, By
(Signed) C. R. Krigbaum, Internal Revenue Agent
in Charge.

Enclosures: Statement. Form of waiver.
LAL:mlm.

Statement

Estate of Henry W. Putnam, Deceased, Guaranty Trust Company of New York, Executor, 140 Broadway, New York, New York.

Tax Liability for Taxable Year Ended December 31, 1938

	<i>Liability</i>	<i>Assessed</i>	<i>Deficiency</i>
Income Tax	\$49,455.81	\$47,946.68	\$1,509.13

In making this determination of the income tax liability of Henry W. Putnam, deceased, careful consideration has [fol. 26] been given to the report of examination dated August 16, 1939; to your protest dated October 17, 1939; and to the statements made at the conferences held on November 6, 1939, and January 31, 1940.

A copy of this letter and statement has been mailed to your representative Mr. William H. Gambrell, 15 Broad Street, New York, New York, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

Adjustments to Net Income

Net income as disclosed by return	\$123,428.94
Unallowable deductions and additional income:	
(a) Dividends	\$2,400.00
(b) Taxes	34.09
Net income adjusted	\$125,863.03

Explanation of Adjustments

(a) Dividends declared prior to date of death, payable to stockholders of record on dates after the date of death, are held to constitute income to the decedent under the provisions of section 42 of the Revenue Act of 1938.

(b) Overaccrual in amount of \$34.09 of New York State income tax for the period January 1 to March 30, 1938, is disallowed, as follows:

Amount deducted on the return	\$15,832.63
Amount which accrued at date of death	15,798.54
Difference	\$ 34.09

[fol. 27] Computation of Tax Revenue Act of 1938

Net income adjusted	\$125,863.03
Plus: Long-term capital loss	243.56
Ordinary net income	\$126,106.59
Less: Personal exemption	1,000.00
Balance (surtax net income)	\$125,106.59
Less: Earned income credit	300.00
Net income subject to normal tax	\$124,806.59
Normal tax at 4% on \$124,806.59	\$ 4,992.26
Surtax on \$125,106.59	44,561.82
Partial tax	\$ 49,554.08
Minus: 30% of net long-term capital loss	73.07
Total tax	\$ 49,481.01
Less: Income tax paid at source	25.20
Corrected income tax liability	\$ 49,455.81
Income tax assessed:	
Original, Account No. 813226	47,946.68
Deficiency of income tax	\$ 1,509.13
LAL:mlm	

[fol. 28] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 102690

[Same title]

ANSWER—Filed July 6, 1940

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and in answer to the petition filed herein, admits, denies and avers as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.

3. Denies that the taxes in controversy are income taxes of the decedent for the calendar year 1938 and avers that while the notice of deficiency on which this appeal is taken appears upon its face to be a notice for the calendar year 1938, a reading of the entire notice reveals that it is a deficiency notice for the period beginning January 1, 1938, and ending March 30, 1938, which latter date the respondent admits to be the date of the death of the decedent, Henry W. Putnam. Denies the remaining allegations contained in paragraph 3 of the petition.

4. Denies that the respondent erred as alleged in subparagraphs (a) and (b) of paragraph 4 of the petition. Denies all the allegations of fact contained in said subparagraphs.

[fol. 29] 5(a), (b). Admits the allegations contained in subparagraphs (a) and (b) of paragraph 5 of the petition.

5(c). Admits that the said dividend was not included by the petitioner in the return filed for the period beginning January 1, 1938, and ending March 30, 1938. Admits that the Commissioner included said dividend in the income of the decedent for the period beginning January 1, 1938 and ending March 30, 1938, as income accrued at the date of his death under Section 42 of the Revenue Act of 1938. Denies the remaining allegations contained in subparagraph (c) of paragraph 5 of the petition.

5(d). Denies the allegations contained in subparagraph (d) of paragraph 5 of the petition.

5(e). Admits that in its return for the period beginning January 1, 1938, and ending March 30, 1938, petitioner included the dividends enumerated in subparagraph (e) in determining the taxable income computed on said return. Further admits that the said dividends were declared before the death of the decedent but were payable to stockholders of record on the date set forth in subparagraph (e) of paragraph 5 of the petition. Denies the remaining allegations contained in subparagraph (e) of paragraph 5 of the petition.

5(f). Admits the allegations contained in subparagraph (f) of paragraph 5 of the petition.

5(g). Denies the allegations contained in subparagraph (g) of paragraph 5 of the petition.

[fol. 30] Denies generally and specifically each and every allegation contained in the petition not hereinabove admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved and the appeal denied.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: E. O. Hanson, Division Counsel; Leonard A. Spalding, Jr., Special Attorney, Bureau of Internal Revenue.

EBG.

7/1/40.

[fol. 31] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Same title]

Findings of Fact and Opinion

Docket Nos. 102689, 102690. Promulgated October 28, 1941

Where dividends are declared payable in future to stockholders of record on a future date and a stockholder dies after the declaration of dividend but before the future record date, *held*:

(1) The question of whether such dividends are corporate debts upon declaration and thus accruable to decedent must be determined by the law of the corporation's domicile.

(2) Such dividends declared by corporations domiciled in New Jersey are accruable to decedent, following *Estate of Lewis Cass Ledyard, Jr.*, 44 B. T. A. 1056.

(3) Such dividends declared by corporations domiciled in Delaware, Pennsylvania, and Maine are not corporate debts upon declaration, but only upon future record dates, it not appearing that the law of these

states is contrary to the general rule, to which the laws of New York and New Jersey are exceptions.

J. H. Nichols, Esq., for the petitioner.

L. A. Spalding, Esq., for the respondent.

In Docket No. 102690, the respondent determined a deficiency in income tax liability in the amount of \$1,509.13 against Henry W. Putnam, the decedent. This deficiency [fol. 32] is based upon the exclusion from taxable income of the decedent of dividends in the amount of \$2,400 declared prior to decedent's death, but not payable, however, until a month after his death and then to stockholders of record as of a week after his death. The respondent partially disallowed an accrual for taxes paid, the disallowance amounting to \$34.09.

In Docket No. 102689, the respondent determined a deficiency in income tax liability against the decedent's estate in the amount of \$2,658.64, based on the failure to report \$21,651.75 in dividends received by the estate, although declared prior to the decedent's death. A second factor in this docket was the asserted failure to report \$557.42 in dividends received by the estate, because deemed by the estate to be nontaxable.

In its petition in Docket No. 102689 the petitioner claims an overpayment by the estate of \$2,400 in dividends now sought to be taxed as income of the decedent, and claims that respondent erred in adding to the gross income of the estate the amount of \$21,651.75.

In its petition in Docket No. 102690 the petitioner claims that respondent erred in refusing to exclude from decedent's gross income as reported in the income tax return for 1938 the amount of \$21,651.75 which petitioner alleges was not the income of the decedent. Petitioner also claims respondent erred in adding to decedent's gross income the amount of \$2,400.

These two proceedings were consolidated for hearing and decision.

The sole question presented is whether dividends declared prior to the death of an individual stockholder, payable to stockholders of record on record dates subsequent to his death and payment dates subsequent to such record [fol. 33] dates, are properly includible in the income tax re-

turn of that individual, or whether they are properly includible in the income tax return of his estate.

FINDINGS OF FACT

The facts in these proceedings have been fully stipulated and are as follows:

1. The late Henry W. Putnam died on March 30, 1938. At the time of his death and at all times during 1938 until the time of his death he was a citizen of the United States of America and a resident of the Savoy-Plaza Hotel, Fifth Avenue and 59th Street, in the Borough of Manhattan, City, County and State of New York.

2. Guaranty Trust Company of New York is a corporation incorporated and existing under the laws of the State of New York, having its principal office and place of business at No. 140 Broadway, in said Borough of Manhattan.

3. Said Guaranty Trust Company of New York qualified as Executor of the Estate of said Henry W. Putnam in the Surrogates' Court of the County of New York on June 16, 1938, and is still qualified and acting as such Executor.

4. The Petitioner is the Estate of said Henry W. Putnam, deceased, Guaranty Trust Company of New York, Executor.

5. Said Henry W. Putnam at the date of his death owned 4,800 shares of Common Stock of The American Smelting & Refining Company, a New Jersey corporation. A dividend of \$2,400 (50¢ per share) on said shares owned by said [fol. 34] decedent was declared by said Company on March 1, 1938, payable on May 31, 1938, to stockholders of record on May 6, 1938. The petitioner received said dividend in the amount of \$2,400 on or about May 31, 1938.

6. The Petitioner also received dividends in the total amount of \$21,651.75 on shares of stock owned by said decedent at the date of his death on or about the payment dates as set forth below:

Dividend of \$1.25 per share on 1,255 shares General Motors Corporation (a Delaware corporation) \$5 Preferred Stock, declared on February 7, 1938, payable on May 2, 1938, to stockholders of record on April 4, 1938.....	\$1,568.75
---	------------

Dividend of 50¢ per share on 50 shares United Profit Sharing Corporation (a Delaware corporation) Preferred Stock, declared on February 24, 1938, payable on April 30, 1938, to stockholders of record on March 31, 1938	25.00
Dividends of 25¢ per share on 1,100 shares Westinghouse Air Brake Manufacturing Company (a Pennsylvania corporation) Common Stock, declared on November 16, 1937, payable on April 30, 1938, July 30, 1938, and October 31, 1938 to stockholders of record on March 31, 1938, June 30, 1938, and September 30, 1938, respectively	825.00
Dividend of 15¢ per share on 2,000 shares Hecker Products Corporation (a New Jersey corporation) Common Stock, declared on March 23, 1938, payable on May 2, 1938, to stockholders of record on April 9, 1938	300.00
[fol. 35] Dividend of 20¢ per share on 290 shares Philadelphia Company (a Pennsylvania corporation) Common Stock, declared on March 18, 1938, payable on April 25, 1938, to stockholders of record on April 1, 1938	58.00
Dividend of 87½¢ per share on 1,000 shares United States Smelting, Refining & Mining Company (a Maine corporation) 7% Preferred Stock, declared on March 23, 1938, payable on April 15, 1938, to stockholders of record on April 1, 1938	875.00
Dividends of \$1 per share on 18,000 shares American Can Company (a New Jersey corporation) Common Stock, declared on March 29, 1938, payable on May 16, 1938, to stockholders of record on April 25, 1938	18,000.00
Total	<hr/> \$21,651.75

7. The Petitioner duly filed with the Collector of Internal Revenue for the Second District of New York, at the Custom House, in said Borough of Manhattan, a 1938 United States income tax return on Form 1040 for said decedent for the period from January 1, 1938, to March 30, 1938, the date of death of said decedent, and a 1938 United States fiduciary income tax return on Form 1041 for the

Estate of said decedent for the period from March 30, 1938, the date of death of said decedent, to December 31, 1938.

8. The Petitioner included in said return for the Estate of said decedent for the period from March 30, 1938, to December 31, 1938, said dividend of \$2,400 described in paragraph 5 above.

[fol. 36] 9. The Petitioner included in said return for said decedent for the period from January 1, 1938, to March 30, 1938, the dividends in the total amount of \$21,651.75 described in paragraph 6 above.

OPINION

KERN :

The question which this proceeding poses is whether dividends declared prior to the death of decedent but which, by the terms of the declaration, are payable only to stockholders of record as of a date subsequent to decedent's death are accruable to decedent and taxable as his income, or are taxable as the income of his estate.

Upon this question the law of the domicile of the corporation declaring the dividend is controlling and it is to such law that we must look in determining whether and at what time a corporate debt arises pursuant to such declaration. *Helvering v. McGlue*, 119 Fed. (2d) 167; *Estate of Lewis Cass Ledyard, Jr.*, 44 B. T. A. 1056.

In those cases it was held that under the laws of New York and New Jersey, in which states the corporations involved were domiciled, a corporate debt arises upon the declaration of a dividend even though the dividend is payable to stockholders of record on some future date.

That rule, however, in effect in New York and New Jersey, does not represent the weight of authority. The rule in Connecticut and Massachusetts is to the effect that where dividends declared are, by the terms of the declaration, payable to stockholders of record at some future date, the corporate debt on account of such dividend does not arise until the future record date. *Union & New Haven Trust Co. v. Watrous*, 109 Conn. 268; 146 Atl. 727; *Richter & Co. v. Light*, 97 Conn. 364, 116 Atl. 600; *Nutter v. Andrews*, 246 Mass. [fol. 37] 224; 142 N. E. 67. *Dicta* in decisions in other states are in accord. See *Ford v. Ford Manufacturing Co.*, 222 Ill. App. 76; *In re Opperman's Estate*, 319 Pa. 455; 179 Atl. 729.

This latter rule seems to be that recognized by the Federal courts. *Sharp v. Commissioner*, 91 Fed. (2d) 802; *Buchanan v. National Savings & Trust Co.*, 23 Fed. (2d) 994. See *Alexander & Alexander, Inc. v. United States*, 22 Fed. Supp. 921, 923. However, compare *Lamberth v. Commissioner*, 120 Fed. (2d) 101, wherein the Circuit Court of Appeals for the Ninth Circuit erroneously and unnecessarily cites *Helvering v. McGlue*, *supra*, as authority for a general rule, whereas it is obvious that it merely stated the rule existing in New York. Compare also *First National Bank & Trust Co. v. Glenn*, 36 Fed. Supp. 552, wherein a contrary rule is stated on the sole authority of New York decisions. This latter rule of substantive corporation law was recognized by us as the general rule to be applied in *Estate of G. Percy McGlue*, 41 B. T. A. 1186. This case was reversed, but on the ground that the law of New York, the state in which the corporation was domiciled, was not in accord with the rule which we there took and which we now, after careful consideration, continue to take as representing the weight of authority.

In the absence of a convincing showing that the law of the corporation's domicile is to the contrary, we shall continue to apply the rule which we consider to represent the weight of authority, viz., that, where a corporation declares a dividend payable in the future to stockholders of record on some future date, a corporate debt on account of such dividend does not arise until such future date and, in the event a stockholder dies before such future record date, the dividend is not accruable to him and is not taxable as his income.

[fol. 38] In the instant proceeding the corporations declaring the dividends involved were domiciled in New Jersey, Delaware, Pennsylvania, and Maine. As to the dividends declared by the New Jersey corporations, we hold, pursuant to *Estate of Lewis Cass Ledyard, Jr.*, *supra*, that they were taxable as income of decedent. As to the dividends declared by the Delaware, Pennsylvania, and Maine corporations, we hold that they were not accruable to decedent and taxable as his income, but were taxable as the income of his estate.

Reviewed by the Board.

Decision will be entered under Rule 50.

Arundell, Smith, Turner, Mellott, and Oppen dissent.

[fol. 39] BEFORE UNITED STATES BOARD OF TAX APPEALS
Washington

Docket No. 102689

[Same title]

DECISION

Pursuant to the findings of fact and opinion of the Board promulgated October 28, 1941, the parties herein on November 24, 1941 having filed an agreed recomputation of tax, now, therefore, it is

Ordered and decided: That there is a deficiency in income tax for the calendar year 1938 in the amount of \$60.36.

(Signed) John W. Kern, Member. (Seal.)

Enter:

Entered Nov. 25, 1941.

[fol. 40] BEFORE UNITED STATES BOARD OF TAX APPEALS
Washington

Docket No. 102690

[Same title]

DECISION

Pursuant to the findings of fact and opinion of the Board promulgated October 28, 1941, the parties herein on November 26, 1941 having filed an agreed recomputation of tax, now, therefore, it is

Ordered and decided: That there is an overpayment of income tax for the calendar year 1938 in the amount of \$568.95, which amount was paid within three years before the filing of the petition (Sec. 322 (d), Revenue Act of 1938).

(Signed) John W. Kern, Member. (Seal.)

Enter:

Entered Nov. 27, 1941.

[fol. 41] IN THE UNITED STATES CIRCUIT COURT OF APPEALS,
FOR THE SECOND CIRCUIT

B. T. A. Nos. 102689 and 102690

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner on Review,

v.

ESTATE OF HENRY W. PUTNAM, DECEASED, Guaranty Trust
Company of New York, Executor, Respondent on Review

Petition for Review and Assignments of Error—Filed
February 18, 1942

To the Honorable Judges of the United States Circuit Court
of Appeals for the Second Circuit:

Now comes the Commissioner of Internal Revenue, by his
attorneys (Samuel O. Clark, Jr., Assistant Attorney Gen-
eral, J. P. Wenchel, Chief Counsel, Bureau of Internal
Revenue, and John M. Morawski, Special Attorney, Bureau
of Internal Revenue, and respectfully shows:

I

Jurisdiction

The petitioner on review is the duly appointed, qualified
and acting Commissioner of Internal Revenue, hereinafter
referred to as the Commissioner, holding his office by virtue
of the laws of the United States.

[fol. 42] The respondent on review (hereinafter referred
to as the taxpayer) in the Estate of Henry W. Putnam, de-
ceased, Guaranty Trust Company of New York, Executor.
Said Guaranty Trust Company of New York is a corpora-
tion incorporated under the laws of the State of New York,
having its principal office and place of business at 140
Broadway, New York, New York. Said Guaranty Trust
Company of New York is the duly qualified and acting ex-
ecutor of the Estate of Henry W. Putnam, deceased. The
income tax return for the periods here involved were filed
with the Collector of Internal Revenue for the Second Dis-
trict of New York, whose office is located within the judicial
circuit of the United States Circuit Court of Appeals for
the Second Circuit.

The Commissioner files this petition pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

II

Prior Proceedings

On March 6, 1940, the Commissioner determined a deficiency in income tax against the taxpayer in the amount of \$1,509.13 in respect of the income of the decedent for the period January 1, 1938, to March 30, 1938, the date of death of the decedent; and also on March 6, 1940, determined a deficiency in income tax against the taxpayer in the amount of \$2,658.64 in respect of the income of the decedent's estate for the period March 31, to December 31, 1938; and sent to the taxpayer by registered mail notices of said deficiencies in accordance with the provisions of existing internal revenue laws. Thereafter, and on May 16, 1940, the taxpayer filed petitions for redetermination of said deficiencies by the United States Board of Tax Appeals.

[fol. 43] The cases were tried before the Board of Tax Appeals on March 31, 1941, at New York, New York.

On October 28, 1941, the Board promulgated its findings of fact and opinion (45 B. T. A. — No. 84), and on November 25, 1941, entered its decision, relating to income of the decedent's estate, that there is a deficiency in income tax for the calendar year 1938 in the amount of \$60.36; and on November 27, 1941, entered its decision, relating to income of the decedent, that there is an overpayment of income tax for the calendar year 1938 in the amount of \$568.95, which amount was paid within three years before the filing of the petition (Section 322(d), Revenue Act of 1938).

III

Nature of Controversy

The question presented to the Board was whether dividends declared prior to the death of decedent but which, by the terms of the declaration, are payable only to stockholders of record as of a date subsequent to decedent's death are accruable to decedent and taxable as his income under the provisions of Section 42 of the Revenue Act of 1938, or are taxable as the income of his estate.

The facts were stipulated and are set out in the Board's findings of fact. The Commissioner contended that certain dividends amounting to \$24,051.75 are taxable to the decedent. Of these dividends \$20,700.00 were declared by New Jersey corporations and \$3,351.75 by Delaware, Pennsylvania and Maine corporations. The Board, in sustaining the Commissioner in part, held that the dividends declared by the New Jersey corporations were taxable as income of decedent, but, in reversing the Commissioner in part, held [fol. 44] that the dividends declared by the Delaware, Pennsylvania and Maine corporations, amounting to \$3,351.75, were not accruable to decedent and taxable as his income but were taxable as the income of his estate. Five members of the Board dissented without opinion.

IV

Assignments of Error

The Commissioner avers that in the record and proceeding before the Board of Tax Appeals and in the opinion and final decision rendered and entered by the Board of Tax Appeals, manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following errors and each of them, which he avers occurred in said record, proceeding, opinion and final decision so rendered and entered by the Board of Tax Appeals:

The Board of Tax Appeals erred:

1. In holding in Docket No. 102690 (relating to income of the decedent for the period January 1, to March 30, 1938) that there is an overpayment of income tax for the calendar year 1938 in the amount of \$568.95 which amount was paid within three years before the filing of the petition (Sec. 222(d), Revenue Act of 1938).

2. In failing to hold in Docket No. 102690 that there is a deficiency in income tax for the calendar year 1938 in the amount of \$1,509.13. (In the event such deficiency is ultimately determined, then appropriate adjustment should be made in the tax liability in the case of Docket No. 102689 and decision entered therein accordingly.)

[fol. 45] 3. In holding that in the absence of a convincing showing that the law of the corporation's domicile is to the contrary, "we shall continue to apply the rule which we

consider to represent the weight of authority, viz., that where a corporation declares a dividend payable in the future to stockholders of record on some future date, a corporate debt on account of such dividend does not arise until such future date and, in the event a stockholder dies before such future record date, the dividend is not accruable to him and is not taxable as his income."

4. In failing to hold that the irrevocable declaration of a dividend by a corporation creates a debt due from the corporation to its stockholders regardless of the fact that the dividend is payable to stockholders of a later record date, and, in the event a stockholder dies before such future record date, the dividend is accruable to him and is taxable as his income.

5. In holding that the dividends declared by the Delaware, Pennsylvania and Maine corporations in the amount of \$3,351.75 are taxable as the income of the decedent's estate.

6. In failing to hold that the dividends declared by the Delaware, Pennsylvania and Maine corporations in the amount of \$3,351.75 are properly includible in the income tax return of the decedent for the taxable year based upon his income for the period beginning January 1, 1938, and ending March 30, 1938, under the provisions of Section 42 of the Revenue Act of 1938.

7. In that its decision is not supported by the evidence and is contrary to law.

[fol. 46] Wherefore, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Second Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed by said Court.

(Sgd.) Samuel O. Clark, Jr., Assistant Attorney General; (Signed) J. P. Wenchel, RLW, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: J. M. Morawski, Special Attorney, Bureau of Internal Revenue.

[fol. 47] *Duly sworn to by John M. Morawski. Jurat omitted in printing.*

[fol. 48] IN THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

B. T. A. Nos. 102689 and 102690

[Same title]

NOTICE OF FILING PETITION FOR REVIEW—Filed February
23, 1942

To Guaranty Trust Company of New York, Executor, Estate of Henry W. Putnam, Deceased, 140 Broadway, New York, New York.

You are hereby notified that the Commissioner of Internal Revenue did, on the 18th day of February, 1942, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

[fol. 49] Dated this 18th day of February, 1942.

(Signed) J. P. Wenchel, RLW, Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 19th day of February, 1942.

Guaranty Trust Co. of New York, Executor of Estate of Henry W. Putnam, by (Sgd.) W. C. Bloom,
Trust Officer.

Respondent on Review.

[fol. 50] IN THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

B. T. A. Nos. 102689 and 102690—

[Same title]

NOTICE OF FILING PETITION FOR REVIEW—Filed February
23, 1942

To James H. Nichols, Esquire, 15 Broad Street, New York,
New York.

You are hereby notified that the Commissioner of Internal Revenue did, on the 18th day of February, 1942, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

[fol. 51] Dated this 18th day of February, 1942.

(Signed) J. P. Wenchel, RLW, Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 19th day of February, 1942.

(Sgd.) James H. Nichols, Counsel for Respondent
on Review.

[fol. 52] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR
THE SECOND CIRCUIT

Board of Tax Appeals Docket No. 102690

ESTATE OF HENRY W. PUTNAM, Deceased, Guaranty Trust
Company of New York, Executor, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

(1938 Income Tax of Decedent)

Board of Tax Appeals Docket No. 102689

ESTATE OF HENRY W. PUTNAM, Deceased, Guaranty Trust
Company of New York, Executor, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

(1938 Income Tax of Estate)

Petition for Review and Assignments of Error—Filed Feb-
ruary 25, 1942

To the Honorable, the Judges of the United States Circuit
Court of Appeals for the Second Circuit

[fol. 53] Now comes the Estate of Henry W. Putnam, deceased, Guaranty Trust Company of New York, Executor, a New York corporation, the Petitioner herein, and in support of this its petition filed in pursuance of the provisions of Sections 1141 and 1142 of the Internal Revenue Code for the review of the two decisions and orders herein-after described of the United States Board of Tax Appeals rendered on November 25, 1941, and November 27, 1941, respectively, respectfully shows to this Honorable Court as follows:

I

Statement of the Nature of the Controversy

1. On March 6, 1940, the Commissioner of Internal Revenue, the Respondent herein mailed to the Petitioner, by registered mail, a notice of the determination of a defi-

ciency in income tax in the amount of \$1,509.13 claimed by the Respondent to be due from the Petitioner for the calendar year 1938 under and by virtue of the Revenue Act of 1938 with respect to the income of the late Henry W. Putnam for the portion of the year 1938 during which he was alive, namely from January 1, 1938, to March 30, 1938, and a notice of the determination of a deficiency in income tax in the amount of \$2,658.64 claimed by the Respondent to be due from the Petitioner for the calendar year 1938 under and by virtue of the provisions of the Revenue Act of 1938 with respect to the income of the Estate of said Henry W. Putnam for the portion of the calendar year 1938 from March 30, 1938, to December 31, 1938. On May 16, 1940, the Petitioner duly filed with the United States Board of Tax Appeals (hereinafter called the Board) two petitions for the redetermination of said deficiencies.

[fol. 54] 2. Said deficiencies in income tax claimed by the Respondent to be due from the Petitioner resulted from the inclusion of certain dividends on shares of stock owned by the decedent at the date of his death, March 30, 1938, in certain New Jersey, Delaware, Pennsylvania and Maine corporations, in the total amount of \$24,051.75, which dividends were declared by such corporations before the date of death, but were payable to stockholders of a record date after the date of death, in the income accrued to the decedent for the period ending with his death and taxable as his income under Section 42 of the Revenue Act of 1938, and in the income of his Estate during the portion of the year 1938 after March 30, 1938. The deficiencies claimed in said two notices were inconsistent, in that said notices included said dividends in both the income of the decedent for the portion of the year 1938 during which he was alive and in the income of his Estate for the balance of said year.

3. All the facts involved in the cases were stipulated and the cases were tried before the Board on March 31, 1941, at New York, New York. At the hearing the two cases were consolidated for hearing and decision. On October 28, 1941, the Board promulgated its opinion in said appeals (45 B. T. A. No. 84) holding that the dividends of said New Jersey corporations in the total amount of \$20,700 were includible in the income of the decedent for the portion of the year 1938 during which he was alive, and that the dividends of said Delaware, Pennsylvania and Maine

corporations in the total amount of \$3,351.75 were includible in the income of the Estate of said decedent for the balance of said year.

[fol. 55] 4. On November 25, 1941, the Board rendered and entered in its records a decision and order in accordance with said opinion whereby it determined the amount of the deficiency in income tax due from the Petitioner on account of the income of the Estate of said decedent for the year 1938 to be \$60.36.

5. On November 27, 1941, the Board rendered and entered in its records a decision and order in accordance with said opinion whereby it determined an overpayment of income tax by the Petitioner with respect to the income of said decedent for the portion of the year 1938 during which he was alive in the amount of \$568.95, which amount was paid within three years before the filing of the petition.

II

Declaration of the Court in Which the Review is Sought

The Petitioner, feeling aggrieved by said decisions and orders, hereby petitions for the review thereof by the United States Circuit Court of Appeals for the Second Circuit, in which Circuit is located the office of the Collector of Internal Revenue to which was made the returns in respect of which the liability involved in this proceeding arises.

III

Assignments of Error

The Petitioner as a basis for the review of said decisions and orders, makes the following assignments of error:

[fol. 56] 1. The Board erred in holding that under the law of New Jersey a corporate debt arises upon the declaration of a dividend where the dividend is payable to stockholders of record on some future date.

2. The Board erred in including the dividends of said stocks of said New Jersey corporations in the total amount of \$20,700 in the income of the decedent pursuant to Section 42 of the Revenue Act of 1938, for the portion of the year 1938 during which he was alive, rather than in the

income of the Estate of the decedent for the balance of such year.

3. The Board erred in deciding that there was an overpayment of only \$568.95 of income tax for the calendar year 1938 with respect to the income of the decedent for the portion of such year during which he was alive.

4. The Board erred in refusing to decide that there was an overpayment of \$13,576.95 of income tax for the calendar year 1938 with respect to the income of the decedent for the portion of such year during which he was alive.

5. The Board erred in deciding that there was a deficiency of \$60.36 of income tax for the calendar year 1938 with respect to the income of the Estate of said decedent.

6. The Board erred in refusing to decide that there was an overpayment of \$41.12 of income tax for the calendar year 1938 with respect to the income of the Estate of said decedent.

[fol. 57] Wherefore your Petitioner prays that said decisions and orders of the Board be reviewed and modified or reversed by the United States Circuit Court of Appeals for the Second Circuit in accordance with law and for such other and further relief as said Court may deem meet and proper in the premises.

Estate of Henry W. Putnam, Deceased, Guaranty Trust Company of New York, Executor, Petitioner, by W. C. Bloom, Trust Officer; Carl A. de Gersdorff, William H. Gambrell, James H. Nichols, Attorneys for the Petitioner, 15 Broad Street, New York, New York.

Cravath, de Gersdorff, Swaine & Wood.

[fol. 58] *Duly sworn to by W. C. Bloom. Jurat omitted in printing.*

[fol. 59] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR
THE SECOND CIRCUIT

Board of Tax Appeals Docket No. 102690

Board of Tax Appeals Docket No. 102689

[Same Titles]

NOTICE OF FILING PETITION FOR REVIEW—Filed February 25,
1942

To: J. P. Wenchel, Esq., Chief Counsel, Bureau of Internal
Revenue, Attorney for the Respondent, Washington, D. C.

SIR:

Please take notice that on the 25th day of February, 1942, the Estate of Henry W. Putnam, deceased, Guaranty Trust Company of New York, Executor, the Petitioner in the above-entitled proceedings, filed with the Clerk of the United States Board of Tax Appeals the petition of said Petitioner, a copy of which is annexed hereto, for the review by the United States Circuit Court of Appeals for the Second Circuit of the two decisions and orders of said Board rendered and entered in its records in the above-entitled proceedings on November 25, 1941, and November 27, 1941.
[fol. 60] Dated, New York, N. Y., February 25, 1942.

Carl A. de Gersdorff, William H. Gambrell, James H. Nichols, Counsel for the Petitioner, Estate of Henry W. Putnam, Deceased, Guaranty Trust Company of New York, Executor, 15 Broad Street, New York, N. Y.

Cravath, de Gersdorff, Swaine & Wood.

ADMISSION OF SERVICE

Receipt of the foregoing notice of filing of petition for review and service of a copy of the petition therein mentioned are acknowledged this 25th day of February, 1942.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Attorney for the Respondent.

[fol. 61] IN THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

B. T. A. Docket Nos. 102689—102690

[Titles omitted]

ORDER RE CONSOLIDATION—Filed March 13, 1942

Now on consideration of the joint motion filed herein by counsel for the respective parties to the above-entitled proceedings, it is

[fol. 62] Ordered, that the above-entitled proceedings be and they are hereby consolidated for briefing, hearing, argument and decision upon a single consolidated transcript of record, to be certified and transmitted to this Court by the Clerk of the United States Board of Tax Appeals, and that the costs of printing the consolidated record on review be borne one-half by each of the petitioners on review.

It is further ordered that the Clerk of this Court transmit to the Clerk of the United States Board of Tax Appeals a certified copy of this order to be by him incorporated in the record on review as certified and transmitted by him to this Court.

Enter:

(S.) Augustus N. Hand, Circuit Judge.

Dated: March 11, 1942.

A True copy:

(S.) D. E. Roberts, Clerk. (Seal.)

[fol. 63] IN THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

B. T. A. Docket Nos. 102689 and 102690

B. T. A. Docket Nos. 102689 and 102690

[Same Titles]

PRAECIPE FOR RECORD—Filed March 9, 1942

To the Clerk of the United States Board of Tax Appeals:

You are hereby requested to prepare, certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Second Circuit, with reference to the petition and

cross-petition for review heretofore filed in the above-entitled cause, a transcript of the record in said cause, prepared and transmitted as required by law and by the rules of said Court, and to include in said transcript of record duly certified copies of the following:

- (1) Docket entries of the proceedings before the Board.
- (2) Pleadings before the Board:
 - (a) Petitions.
 - (b) Answers.
- (3) Findings of fact, opinion and decisions of the Board.
- (4) Petition for review.
- (5) Notices of filing petitions for review.
- [fol. 64] (6) Court order of consolidation.
- (7) This praecipe.

(Signed) J. P. Wenchel, RLW; J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Attorney for Commissioner of Internal Revenue. (Sgd.) Carl A. de Gersdorff, William H. Gambrell, James H. Nichols, Attorneys for Taxpayer, 15 Broad Street, New York, New York.

[fols. 65-66] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 67] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE
SECOND CIRCUIT, OCTOBER TERM, 1943

No. 5

Argued March 30, 1944. Decided August 4, 1944

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

GUARANTY TRUST COMPANY OF NEW YORK, Executor,
Respondent

GUARANTY TRUST COMPANY OF NEW YORK, Executor,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Before L. Hand, Swan and Chase, Circuit Judges

[fol. 68] PETITIONS TO REVIEW DECISIONS OF THE UNITED
STATES TAX COURT

These cross petitions bring up for review upon a consolidated record two orders of the Tax Court [45 B. T. A. 517] involving the income tax liability of Henry W. Putnam, who died on March 30, 1938, and of his estate. Reversed and remanded with directions.

Samuel O. Clark, Jr., Assistant Attorney General, Sewall Key, Robert N. Anderson and Irving I. Axelrad, Special Assistants to the Attorney General, for the Commission.

Carl A. De Gersdorff and Wm. Dwight Whitney, for the Taxpayer; James H. Nichols, William H. Gambrell and Cravath, Swaine & Wood, of counsel.

SWAN, Circuit Judge:

The question presented by these petitions is whether dividends declared before the death of an individual stockholder but payable by the terms of the declaration to stockholders of record on dates which fell after his death, were income taxable to the decedent or to his estate.

The facts are not in dispute. Henry W. Putnam, a resident of New York, died on March 30, 1938 owning shares

of stock in several corporations organized respectively under the laws of New Jersey, Delaware, Pennsylvania and Maine. Before his death each of the corporations declared a cash dividend payable in the future to stockholders of record on a future date. The relevant facts as to each [fol. 69] dividend are shown in the margin.¹ Although there is no express finding on the point, the parties have assumed, as do we, that the decedent kept his books upon the basis of cash receipts and disbursements. In due course the dividends in question were paid to the executor, and thereafter he filed an income tax return for the decedent for the period from January 1 to March 30, 1938, and an income tax return for the estate for the period from March 30 to December 31, 1938. In the former return he included all the dividends except one of \$2400, which he included in the estate's return. The commissioner surcharged the decedent's return by inclusion of the \$2400 dividend. Then to protect himself against an adverse decision, the commissioner likewise surcharged the estate's return by including all the dividends as income of the estate. The executor appealed to the Board of Tax Appeals (now the Tax Court) from both determinations. The Tax Court [fol. 70] held, five members dissenting without opinion, that the dividends of New Jersey corporations were accruable as income to the decedent and the dividends of Delaware, Maine and Pennsylvania corporations were not so accruable and were therefore income to the estate. The executor's petition attacks the former conclusion, the commissioner's petition the latter.

¹ Corporation	State of incorpora- tion	Amount of dividend	Declara- tion date	Record date	Payment date
1. American Smelting & Refining Co.	New Jersey	\$2,400.00	3/ 1/1938	5/ 6/1938	5/31/1938
2. General Motors Corp.	Delaware	1,568.75	2/ 7/1938	4/ 4/1938	5/ 2/1938
3. United Profit Sharing Corp.	Delaware	25.00	2/24/1938	3/31/1938	4/30/1938
4. Westinghouse Air Brake Mfg. Co.	Pennsylvania	\$25.00	11/16/1937	3/31/1938 6/30/1938	4/30/1938 7/30/1938
5. Hecker Products Corp.	New Jersey	300.00	3/23/1938	4/ 9/1938	5/ 2/1938
6. Philadelphia Co.	Pennsylvania	58.00	3/18/1938	4/ 1/1938	4/25/1938
7. United States Smelting, Refining & Mining Co.	Maine	\$75.00	3/23/1938	4/ 1/1938	4/15/1938
8. American Can Co.	New Jersey	18,000.00	3/29/1938	4/25/1938	5/16/1938

Section 42 of the Revenue Act of 1938, 52 Stat. 447, reads as follows:

"The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period."

The second sentence of the section originally appeared in the corresponding section of the Revenue Act of 1934; the congressional purpose in inserting it is explained in *Helvering v. Enright's Estate*, 312 U. S. 636, 639. It was eliminated in the Revenue Act of 1942.²

The decision of the Tax Court, 45 B. T. A. 517, went upon the ground that whether the dividends became corporate debts upon declaration and thus accruable to the decedent must be determined by the law of the corporation's [fol. 71] domicile. Before us both petitioners have argued that state law concepts of accrual are not controlling; they agree that the question is one of federal law calling for a uniform income tax rule throughout the country. We accept this theory, as we believe that "amounts accrued" within the meaning of section 42 presents a federal question which "is not determined by local characterization." See *Lyeth v. Hacy*, 305 U. S. 188, 193.

Against the commissioner's contention that the dividends "accrued" on the declaration date the executor interposes the argument that section 115 inhibits taxing a dividend until it is "made" to the shareholders, or in the words of the relevant regulation, Regs. 101, Art. 115-1, until "the cash or other property is unqualifiedly made subject to their demands". Reliance is placed on *Tar Products Corp. v. Commissioner*, 130 F. 2d 866 (C. C. A. 3) which holds that a dividend is taxable in the year of its receipt, not in the year of its declaration, even when the taxpayer's

² Section 134 of the Revenue Act of 1942, 56 Stat. 798.

books are kept on an accrual basis of accounting. But that case did not involve section 42, and we think it cannot be applied in the light of *Helvering v. Enright's Estate*, 312 U. S. 636. There Mr. Justice Reed said at pages 644-645:

"It is to be noted that no change was made by the 1934 Act in the §48 definition of 'accrued'. Yet, it is obvious that the definition is inapplicable since a taxpayer on a cash basis cannot have a 'method of accounting' by which the meaning of accrual is fixed. * * * It has been frequently said, and correctly, that §42 was aimed at putting the cash receipt taxpayer on the accrual basis. But that statement does not answer the meaning of accrual in this section. * * * Accruals here are to be construed in furtherance of the intent of [fol. 72] Congress to cover into income the assets of decedents, earned during their life and unreported as income, which on a cash return, would appear in the estate returns. Congress sought a fair reflection of income."

Hence the courts have recognized that accrued income under §42 "may be something different than a living taxpayer on an accrual basis may record as accrued income." *Bach v. Rothensies*, 124 F. 2d 306, 307 (C. C. A. 3), cert. den. 316 U. S. 666; *Helvering v. McGlue's Estate*, 119 F. 2d 167, 170 (C. C. A. 4); *Commissioner v. Cohen*, 121 F. 2d 348 (C. C. A. 5); *First Nat. Bank & Trust Co. v. Glenn*, 36 F. Supp. 552 (W. D. Ky.). These four cases all involved the accrual of dividends which the stockholder had not received at the date of his death. It is true that the *McGlue* case went upon the court's understanding of New York law, so that it is not a direct authority on the point before us; it does, however, support the view that "accrued" has a broader meaning in section 42 than the courts have given it in other connections. We are of opinion that within the meaning of the last sentence of section 42 the dividends accrue upon the declaration date rather than the record date. The declaration fixes the amount of the dividend and, being irrevocable by the corporation, it makes reasonably certain that the shareholder will receive payment, unless he dies or by his voluntary act disposes of the dividend before the record date. If he sells the stock the price he

will receive will reflect the value of the declared dividend. "From the economic and practical viewpoint", as Judge Miller said in *First Nat. Bank & Trust Co. v. Glenn*, 36 F. Supp. 552, 556, "the dividend has accrued." The orders are reversed and the cause remanded with directions to accrue the dividends to the decedent and determine the decedent's deficiency and the estate's overpayment accordingly.

[fol. 73] L. HAND, Circuit Judge (dissenting):

The Supreme Court held in *Helvering v. Enright's Estate*, 312 U. S. 636, that under §42 there might be "accruals" which were different from "accruals" in other connections; but the case only involved the value at the time of a partner's death of uncompleted services, performed by a firm of lawyers, some of which might be on a contingent basis, or indeed be only *quantum meruit*. The court held that, although these might not be "accrued" for ordinary purposes, they should be "accrued" in order to effect the purpose of §42, for otherwise the income would altogether escape taxation, which it was the purpose of the amendment to avoid. However, it is one thing to hold that one should compute the present value of all the items of unfinished work on a lawyer's books, even though there is a chance of error in doing so because some of the charges are contingent; they have a present value, which ordinarily can be approximately computed. But it is quite another thing, when the very obligee of a claim remains undetermined, arbitrarily to select one of the two or more possible persons who may become the obligee, and say that one will treat him as the owner of the claim. Such a doctrine, when applied between a decedent and his executors, may not indeed work unfairly; but, when applied to sales it leads, I submit, to preposterous results. Suppose the decedent sells the shares after the declaration of a dividend, but before the "record" date. The price of the shares will ordinarily include the dividend, for even the declaration of a dividend makes no difference in the case of companies which declare dividends regularly. Hence the decedent will pay a tax based upon his gain—if he has a gain—it may be a limited tax, but it is an income tax; and if he also pays a tax upon the dividend, he has paid twice. Moreover, even when he merely bequeaths the shares specifically,

to tax the decedent and not the legatee, presupposes that [fol. 74] in some way the company's earnings all along were the decedent's, for the declaration does not change his relation to them. It does set them apart for somebody, but not the decedent, unless he happens to outlive the "record" date. The confusion lies in the fact of treating the certainty that there is a debt as a certainty of the identity of the creditor. Anything is possible, but this goes beyond the declared object of the section, and, incidentally does not always favor the revenue. I agree that *Commissioner v. Cohen*, 121 Fed. (2) 348 (C. C. A. 5) is against this view; but it was based upon a mistaken reading of *Helvering v. McGlue*, 119 Fed. (2) 167 (C. C. A. 4), which went upon the court's understanding, possibly its misunderstanding, of New York Law.

[fol. 75] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND
CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 25th day of August one thousand nine hundred and forty-four.

Present: Hon. Learned Hand, Hon. Thomas W. Swan, Hon. Harrie B. Chase, Circuit Judges.

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

ESTATE OF HENRY W. PUTNAM, Deceased, et al.,
Respondents;

ESTATE OF HENRY W. PUTNAM, Deceased, et al.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the orders of said The Tax Court

of the United States be and hereby are reversed and the cause remanded with directions to accrue the dividends to the decedent and determine the decedent's deficiency and the estate's overpayment accordingly.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

Alexander M. Bell, Clerk, by A. Daniel Fusaro,
Deputy Clerk.

[fol. 76] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Commissioner of Internal Revenue, v. Estate of Henry W. Putnam, et al., Estate of Henry W. Putnam, et al., v. Commissioner of Internal Revenue. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed Aug. 25, 1944. Alexander M. Bell, Clerk.

[fol. 77] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 78] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed November 13, 1944

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on Cover: File No. 48,987. U. S. Circuit Court of Appeals, Second Circuit. Term No. 534. Estate of Henry W. Putnam; Guaranty Trust Company of New York, Executor, Petitioner, vs. Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed October 2, 1944. Term No. 534, O. T. 1944.

(5273)

FILE COPY

Office - Supreme Court, U. S.

FILED

OCT 2 1944

CHARLES ELMORE DROPLEY
CLERK

IN THE
Supreme Court of the United States

OCTOBER TERM, 1944

No. 534

ESTATE OF HENRY W. PUTNAM; GUARANTY
TRUST COMPANY OF NEW YORK, EXECUTOR,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS FOR
THE SECOND CIRCUIT AND BRIEF IN SUPPORT
THEREOF**

WM. DWIGHT WHITNEY,

Counsel for Petitioner,

15 Broad Street,

New York, N. Y.

ROBERT T. SWAINE,
Of Counsel.

September 30, 1944.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1944

ESTATE OF HENRY W. PUTNAM; GUARANTY
TRUST COMPANY OF NEW YORK, Executor,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS FOR
THE SECOND CIRCUIT**

*To the Honorable, the Chief Justice and Associate Justices
of the Supreme Court of the United States:*

Your petitioner, Guaranty Trust Company of New York, a New York Trust Company, as Executor of the Estate of Henry W. Putnam, deceased, respectfully prays that a writ of certiorari issue to review an order, judgment and decree of the United States Circuit Court of Appeals for the Second Circuit, entered August 25, 1944, reversing and remanding with directions the orders of the Board of Tax Appeals entered on November 5, 1941, and November 27, 1941. A certified transcript of the record is furnished herewith in accordance with Rule 38, Par. 1, of the Rules of this Court.

STATEMENT

Henry W. Putnam died on March 30, 1938, owning, among other investments, shares in

General Motors Corporation and United Profit Sharing Corporation, both Delaware corporations;

American Can Company, American Smelting & Refining Company and Hecker Products Corporation, all New Jersey corporations;

Westinghouse Air-Brake Manufacturing Company and Philadelphia Company, both Pennsylvania corporations; and

United States Smelting, Refining & Mining Company, a Maine corporation.

All of these corporations had made dividend declarations prior to the date of his death. In every case, however, the dividend was to be paid only to holders of record on designated dates, all of which dates were subsequent to the date of his death (in one case, six months later). In every case also the payment date was to be subsequent to the record date, generally one month subsequent to the record date.

On the date of death, therefore, the decedent had no right to receive the dividend.

The Commissioner assessed income tax on the dividends both to the decedent and to his Executor, so as to insure collection of income tax either as of the date of declaration or as of the record date. The Executor recognized the obligation of the Estate to pay the tax, as the Estate still held the shares in question on the record date. It disputed,

however, the power of the Commissioner to impute the same income to the decedent during his lifetime.

The Commissioner's doubt was evidently whether § 42 of the Revenue Act of 1938, 52 Stat. 447, applied, the relevant provision being that

"* * * In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period."

The taxpayer's position was that income could not be said to have accrued prior to death, for the dividends had not been declared payable to the decedent, but only to such stockholders as should be on the books on a subsequent date. A dividend declared payable to holders on a subsequent record date confers no rights upon present holders, and hence could not constitute income to such holders under Section 22(a) of said Revenue Act.

The Tax Court,¹ considering itself bound by the 4th Circuit Court of Appeals' decision in *Helvering v. McGlue's Estate*, 119 F. (2d) 167 to apply the law of the State of incorporation as to the date upon which a dividend became "a debt", upheld the assessment to the decedent in the cases of the New Jersey corporations and the assessment to the Estate in the cases of the Delaware, Pennsylvania, and Maine corporations.²

¹The case was heard and decided while the Tax Court was still known as the Board of Tax Appeals.

²In its own decision in *McGlue's Estate*, 41 B. T. A. 1186, the Tax Court had evidently assumed that the question of the date of accrual for income tax purpose of a corporate dividend called for a uniform Federal rule. In this it was reversed by the 4th

The decedent's income for the portion of the year 1938 prior to the death was in higher brackets than the Estate's income for the balance of the year,³ and accordingly there followed cross-appeals to the 2d Circuit Court of Appeals.

The majority of the 2d Circuit Court of Appeals (Swan and Chase, *JJ.*) held (1) that the case called for the application of a uniform Federal rule, and (2) that the rule should be that a dividend accrues for the purposes of § 42 as soon as declared, notwithstanding (a) that the declaration is only to stockholders of record on a date subsequent to the date of death, (b) that a contrary rule (that the record date is determinative) applies in most, if not all, of the States, and (c) that the contrary rule (making the payment date determinative) would also apply for Federal Income Tax purposes in all other cases of taxpayers, those on an accrual as well as those on a cash basis, as had been expressly held by the 3d Circuit Court of Appeals in *Tar Products Corporation v. Commissioner*, 130 F. (2d) 866.

Judge Learned Hand dissented. He agreed that the case called for the application of a uniform Federal rule, but he pointed out that the record date must be determinative, for indeed at the date of death in this case it was still undetermined whether the decedent would have received income at all.

Inasmuch as decision of this case necessarily requires decision as to when the dividend was made under Section 115 of the Revenue Act of 1938, there is a direct conflict

Circuit Court of Appeals,—erroneously (as both the majority and dissenting Judges of the Court below, and both the Commissioner and we ourselves, all agree; cf. *Lyeth v. Hoey*, 305 U. S. 188).

³This was because the Estate distributed substantially all of its income, which thus became taxable to the various distributees

between the decision of the Court below and the decision of the 3d Circuit Court of Appeals in *Tar Products Corporation v. Commissioner*, 130 F. (2d) 866.

And we further submit that the case may fairly be recognized as one of fundamental importance, in that it brings before this Court the practice as to dividends that is now almost universally followed by corporations whose shares are publicly held.

JURISDICTION

Jurisdiction of this Court is invoked under Judicial Code, § 240-(a), as amended by the Act of February 13, 1925 (43 Stat. 938, 28 U. S. C. § 348-(a)). The date of the order, judgment and decree of the Circuit Court of Appeals for the Second Circuit to be reviewed was August 25, 1944.

QUESTION PRESENTED

Whether under the Revenue Act of 1938 a corporate dividend upon shares owned by a decedent, which was declared payable to holders of record on a date subsequent to his death, should be treated as income accrued to him during his lifetime or as income accrued to the shareholder who was of record on the record and payment dates.

REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT

1. The Circuit Court of Appeals has rendered a decision in conflict with a decision of the Third Circuit Court of Appeals on the same matter, viz., the date upon which a corporate dividend is to be taken to have been made for the purpose of Federal Income Tax Law. *Tar Products Corporation v. Commissioner*, 130 F. (2d) 866.

2. The Circuit Court of Appeals has decided an important question of Federal law which has not been, but should be, settled by this Court, in that it has determined the date upon which a corporate dividend, of the type in current universal use by large corporations whose shares are publicly held, is to be deemed to have accrued for the purpose of Federal Income Tax Law.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Second Judicial Circuit, sitting at New York, New York, commanding said Court to certify and send up to this Court, on a date to be designated, a full and complete transcript of the record and of all proceedings in the Circuit Court of Appeals had in this case, to the end that this case may be reviewed and determined by this Court; that the order, judgment and decree of the Circuit Court of Appeals be reversed; and that your petitioner be granted such other and further relief as may seem proper.

GUARANTY TRUST COMPANY OF NEW YORK,
as Executor of the Estate of Henry W.
Putnam, Petitioner,

by WM. DWIGHT WHITNEY,
Counsel for Petitioner,
15 Broad Street,
New York, N. Y.

ROBERT T. SWAINE,
Of Counsel.

September 30, 1944.

BRIEF IN SUPPORT OF PETITION

1. The present case is not within the mischief aimed at by § 42.

As pointed out in *Enright's* case, 312 U. S. at p. 639, § 42 was designed to cure the avoidance of tax which resulted from decisions, of which *Nichols v. United States* 64 Ct. Cls. 241 provided an example, in which income accrued during the lifetime of a decedent who was on a cash basis was held not to be income either to him or to his estate. This would be particularly applicable to earnings, as earnings necessarily represent the reward of labor by the decedent during his lifetime; cf. *Lucas v. Earl*, 281 U. S. 111. It would also be applicable to items accruing over regularly spaced periods of time, such as quarterly or annual taxes, rentals and the like; *Enright's* case, at p. 643. It would *not* be applicable to dividends on the common stock of corporations, whose declaration is entirely within the discretion of the Board of Directors and is made at irregular intervals, governed by the exercise of the directors' judgment as to the condition of the corporation.

Accordingly, in this case, the Commissioner has done what Congress recognized that he could not do in the type of case for which § 42 was provided. He has assessed the Estate. He has himself thus ruled that the income did accrue from the dividend to the estate after the death. This assessment is not disputed by the Executor.⁴

2. Determination of when a dividend accrues for the purposes of § 42 is a question of federal law and not of state law.

Both the majority and dissenting Judges of the court below, and both the Commissioner and the taxpayer in the

⁴For the convenience of the Court, those portions of the Congressional Committee reports dealing with § 42 of the Revenue Act of 1934 (the same as § 42 of the Revenue Act of 1938) are included as an Appendix to this brief.

court below, agreed that this is a question of Federal law. Against this four-fold unanimity may be placed the decision of the Tax Court that State law governs, that is to say, that there is to be a different rule in each State, depending upon the place of incorporation of the dividend-paying companies. Five members of the Tax Court dissented; but they did not state upon what ground—whether because they considered that the question was one of Federal law, or because they disagreed as to one or another of the particular State laws.

Four states were involved—New Jersey, Delaware, Pennsylvania and Maine. After a painstaking effort to determine upon what date those states considered that a dividend became a debt, the majority of the Tax Court held that the dividends of the New Jersey corporation should have been included in the decedent's income, but that the dividends of the Delaware, Pennsylvania and Maine corporations were income to the estate.

The Tax Court's independent view had appeared in the decision in the *McGlue* case, 41 B. T. A. 1186, the relevant portion of which follows (pp. 1193-4):

"The remaining question is whether the dividend on the Bourjois, Inc., stock, which was declared 'during the week of October 19, 1935' and was payable on November 15, 1935, to the stockholders of record on November 1, 1935, had accrued at the date of decedent's death, October 31, 1935, and is therefore includable in decedent's gross estate under section 42 above. We think not. Although the facts are somewhat lacking, we assume that at the time of his death the decedent was the owner of a sufficient number of the shares of stock in question to entitle him to the amount with which he is charged as a

dividend accrued at that time. It is to be noted, however, that the dividend, although declared prior to decedent's death and 'during the week of October 19, 1935', was not payable to the stockholders of record at the time of the declaration, but to those who might be the stockholders of record on November 1, 1935. If by his will McGlue had specifically bequeathed the shares the legatee would have received and been taxable upon the dividend payable November 15, 1935. Until the latter date there was no certainty who would be the stockholders of record on November 1, 1935, and therefore would be entitled to receive the dividend. See *Sharp v. Commissioner*, 91 Fed. (2d) 802. Cf. *William K. Vanderbilt et al., Executors*, 11 B. T. A. 291. This uncertainty of the decedent's right at the time of his death, October 31, 1935, ever to receive the dividend was sufficient, we think, to defeat the accrual of the dividend on that date. In other words, at the time of decedent's death the right to receive the dividend on the Bourjois, Inc., stock had not become fixed. *Spring City Foundry Co. v. Commissioner*, *supra*. [292 U. S. 182]

"Reviewed by the Board."

The Tax Court changed its view in this case because it felt constrained to do so by the fact that the 4th Circuit Court of Appeals had so held (wrongly, as we all think) in reversing the decision in *McGlue's* case, 119 F. (2d) 167. We appreciate that this Court needs no help from counsel on the question of applicability of a single Federal rule to an income tax question so broad as this,—when may a dividend be held to have been made to, and accrued to, a stockholder for purposes of §42. *Lyeth v. Hoey*, 305 U. S. 188.

3. The issue, as stated in the opinion of Judge Learned Hand (dissenting below), is whether there can be income to a party never entitled to receive it.

The seed of the error below lies in the lawyer's instinct to apply, without analysis, the rule of thumb that a dividend becomes a debt when declared. We all learned this rule at Law School; but it is unrealistic under modern conditions, having regard to the practice of dividend-declaration by corporations whose shares are widely held by the public. It is the universal practice of such corporations,—and, indeed, is a practice required by the rules of the principal Stock Exchanges,—to keep stock transfer books, and when dividends or other corporate distributions are declared, to set a future date upon which either the stock transfer books are to be closed or the names of holders of record are to be taken as determinative of the stockholders entitled to receive the dividend.

The question has frequently arisen under local law whether the party entitled to the dividend was the stockholder on the day of declaration, the record date or the day of payment. The great weight of authority in the State Courts is in favor of the record date rule; but there has been some conflict. It was with the decisions on this subject in the various States that the Tax Court was wrestling in this case. And the curious feature of the decision of the Circuit Court of Appeals in this case is that, although it definitely overruled the Tax Court on the question as to whether such State law was applicable, it made no effort to analyze what a proper Federal rule should be as to this new and all-important question, but simply accepted as controlling authority still earlier decisions which also went upon the ground that State law governed.

What we argued below, and what Judge Learned Hand has pointed out in his dissenting opinion, is that under the modern record date practice there is no stockholder who can make a claim to be entitled to a dividend upon the ground that he held the stock on the mere date of declaration. Judge Learned Hand said:

"The confusion lies in the fact of treating the certainty that there is a debt as a certainty of the identity of the creditor."

Each one of the eight corporations in this case had declared a dividend and would owe a debt; but until the record date it was not known to whom the debt would be due and payable,—who would realize income from it,—to whom such income would accrue.

Judge Learned Hand further pointed out the distinction between the question in the present case and the question in the *Enright* case, *supra*, 312 U. S. 636:

"* * * it is one thing to hold that one should compute the present value of all the items of unfinished work on a lawyer's books, even though there is a chance of error in doing so because some of the charges are contingent; they have a present value, which ordinarily can be approximately computed. But it is quite another thing, when the very obligee of a claim remains undetermined, arbitrarily to select one of the two or more possible persons who may become the obligee, and say that one will treat him as the owner of the claim."

4. Failure to review this case may leave in effect an unfortunate misinterpretation of the Court's opinion in *Helvering v. Enright*, 312 U. S. 636.

A paragraph of this Court's opinion in the *Enright* case, at pages 644-645, has been supposed by the Court

below to justify it in not giving an independent analysis of the dividend question on the merits. The paragraph in question, 312 U. S. at 644-645, concluded:

“Accruals here are to be construed in furtherance of the intent of Congress to cover into income the assets of decedents, *earned* during their life and unreported as income, which on a cash return, would appear in the estate returns. *Congress sought a fair reflection of income.*” (Italics ours.)

This Court further stated, (at p. 642) that the question was whether the earnings in that case constituted “an accrual of income” and concluded that they were taxable *because* they were “properly” accrued. This constituted a decision, in conformity to the statute, that the question is in each type of case whether income has in fact *properly* “accrued”.

The opinion further pointed out “That the meaning to be attributed to ‘accrued’ as used in §42 is to be gathered from its surroundings” (at p. 644). The appropriate “surroundings” in the present case may be found in §115 of the Revenue Act of 1938; and §115 provides the definition, in terms applicable throughout the Act, of a “dividend” as a corporate distribution when “made”. Thus, the question under §42 becomes: When was the dividend made to the taxpayer?

We understand that the true construction of this Court’s position in the *Enright* case is to be found in its holding at page 643 that (1) “accrued” had *not* become a “word of art” under the Income Tax Act, and therefore that (2) its meaning under § 42 was open to objective interpretation in each case, unfettered by reference to broader interpretations under other sections, specifically (in that case) under

§ 48 of the Revenue Act of 1934. We understand that this Court was merely disclaiming any slavish adherence to the formula of statutory interpretation that a given word must always have the precisely same meaning wherever it appears in a statute, regardless of its context. We are further confident that this Court did not mean to be understood as saying that the desirability of raising revenue from decedents in itself creates a rule of interpretation, carrying as a consequence that income is to be imputed to decedents under § 42 which would not under other sections be income at all.

The critical question remains: When may a corporate dividend be held to have "*properly accrued*"? The learned Court below was in error in supposing that this Court intended in the *Enright* case to dispense with the duty of construing the governing word employed by Congress—"accrue".

This case is different in all vital respects from *Enright's* case:

(1) As to the factual basis of the cases: whereas earnings may fairly be said to have necessarily accrued during the lifetime of the individual who earned them, no such consideration applies to dividends.

(2) As to the theory of statutory interpretation: whereas there was no other section of statute providing material aid to the interpretation of the word "earnings", Section 115(a) does require to be considered where dividends are involved.

(3) As to the practical results: whereas a decision adverse to the Government in *Enright's* case would have meant that no income tax was payable, as it was under-

stood that the earnings could not in any event be income to the Estate, there was in this case an assessment of the same income to the Estate itself.

The assessment to the Estate has added significance, in that it reflects the doubt of the Commissioner himself that the income had truly "accrued" before the death, even under a "broad" interpretation of the word.

5. None of the prior decisions of circuit courts of appeal has really considered the question.

In *Bach v. Rothensies*, 124 F. (2d) 306 (C. C. A. 3), cert. den. 316 U. S. 666, the question was not presented, although it might have been. In the opinions both in the District Court (at 37 Fed. Supp. 217) and in the Circuit Court of Appeals, as well as in the petition for certiorari, it was *assumed* that the income, represented by the dividends, had accrued at the date of death,⁵ and there was therefore no ground upon which to justify the issuance of a

⁵The question was thus presented by the petition for writ of certiorari in the *Bach* case, Oct. Term 1941, No. 1019, Petition at p. 5:

"Where a taxpayer is a life beneficiary of a spendthrift trust, and where such beneficiary taxpayer and such trust keep their respective books and file their respective income tax returns on the cash basis, does Section 42 of the Revenue Act of 1934, despite the provisions of Sections 162(b) and 164 of that Act to the contrary, upon the death of such beneficiary taxpayer, require the inclusion in his life period income tax return (as "amounts accrued up to the date of his death") of *income accrued* on property of the trust at the date of his death, which was not due to the trust or distributable by it to such beneficiary or his estate until actually collected in subsequent years by the trust? (Italics ours.)

writ of certiorari unless this Court had wished to entertain the argument, advanced in that case, that § 42 was unconstitutional.

We, of course, recognize § 42 to be constitutional. The immediate question presented in this case, *and which has not been presented in any prior case*, is whether when this Court said in the *Enright* opinion (at p. 645) that "Congress sought a fair reflection of income", it intended the courts below to understand that income might be reflected back into the hands of a decedent even in a case in which, at the time of death, there had not yet accrued any right in him to receive it.

Although the Court below recognized that the question should be one of Federal Law, it cited as if they were authority the decisions of two Circuit Courts of Appeals which had determined the question upon the theory that it was governed by State law. *Helvering v. McGlue's Estate*, 119 F. (2d) 167 (C. C. A. 4); *Commissioner v. Cohen*, 121 F. (2d) 348 (C. C. A. 5).

In neither case was a writ of certiorari sought.

In *McGlue's* case, the 4th Circuit Court of Appeals simply held that State law governed, and the State there involved being New York, construed the New York cases as requiring application of the minority rule in favor of the declaration date.⁶ The 4th Circuit was followed by the 5th Circuit, without apparently any independent consideration at all, in *Commissioner v. Cohen*, 121 F. (2d) 348. Now, finally, even the 2nd Circuit, which has discerned that the whole basis of these earlier decisions was an un-

⁶The New York law is in fact in considerable doubt; and Surrogate Foley has expressly held that the record date governs. *Matter of Bashford*, 178 Misc. 951, 36 N. Y. Supp. (2d) 651.

sound one, has considered itself nonetheless bound to follow them in the result.

We respectfully submit that this case really is an extraordinary one, meriting review, in that we here find both the majority of the Second Circuit Court of Appeals and the Commissioner of Internal Revenue relying upon decisions as authoritative, which (as they recognize) were based upon a wholly unsound theory of law.

We are, of course, compelled frankly to concede that the results in those cases were adverse to the taxpayers. But surely, if there ever be a case in which the principle of *cessat ratio cessat ipsa lex* should have application, it is a case in which the now defunct *rationes* were not merely erroneous, but were so because they were based upon consideration of entirely different systems of law (State instead of Federal).⁷

The unfortunate effect of such a defeatist administration of law as is represented by the acceptance of admittedly unsound opinions is aptly illustrated by the present case. The effect upon the Tax Court is worthy of special note. The unfortunate Tax Court had started right by applying a single general rule of law (and as we think, the correct record date rule) to *McGlue's Estate*. It was then put wrong by the 4th Circuit Court of Appeals, which applied the State law heresy. Then, in the present case, the Tax Court accepted the reproof and applied State law. In doing so, it was constrained painstakingly to analyze the laws of four different States. Having done so, it was again reversed by a different Circuit Court of Appeals

⁷And at that only New York State law, which has always been recognized as applying only a minority rule, and which itself may now be different; footnote 6, *supra*.

(the 2nd); yet in an opinion in which the 2nd Circuit Court of Appeals cited as authoritative the decisions of the other Circuit Courts of Appeals whose authority it now said that it had been error for the Tax Court to have accepted.

In the light of this history, we most respectfully submit to the consideration of this Court whether, if it were to deny this writ, it would not be leaving the law in an unsatisfactory condition. We suggest that in justice to the Tax Court (if not to this taxpayer), it would be fit and proper for this Court now to take jurisdiction and to straighten out the important question of law which has been thus confused and distorted by the unfortunate cross-current of decisions to date.

6. The decision below is indistinguishable in principle from that of the Third Circuit Court of Appeals in the *Tar Products* case: and there is, therefore, a direct conflict, meriting review.

In the *Tar Products* case in 130 F. (2d), the 3rd Circuit Court of Appeals was directly presented with the question when, as a matter of Federal Income Tax Law, a dividend is made and accrues to a taxpayer. It held that even in the case of a taxpayer on the accrual basis, the ultimate payment date governs. The Court below has suggested that there is no conflict, on the theory that the *Tar Products* case was decided under §115-(a), but that this Court held in the *Enright* case that §115-(a) is of no moment in a §42 case. But this Court could not have so held, for §115-(a) was not involved or mentioned in the *Enright* case.

The only way that a conflict of circuits could be avoided would be to sanction the co-existence of rules (1) that a

dividend accrues as soon as it is declared, in the case of all stockholders who thereafter die, but (2) does not accrue to other stockholders until it is paid. It would follow that if a stockholder dies and his estate thereafter sells the shares before the payment date, two parties will be taxable for the same dividend,—the decedent, because he was a stockholder at the date of declaration, and the vendee, because he was a stockholder at the payment date.

This is not a far-fetched thought, for it is common practice for months to elapse between the declaration and payment of dividends. Thus, in the present case, approximately three months elapsed between the declaration and payment dates of the dividends of American Smelting & Refining Company and General Motors Corporation, and almost 12 months elapsed between the declaration date and payment date of one of the dividends of Westinghouse Air Brake Manufacturing Company.

If the Income Tax Law is to be held to compel imposition of tax upon two individuals for the same dividend, we respectfully submit that a construction so remarkable should at least be settled as the result only of a decision of this Court.

Respectfully submitted,

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September 30, 1944.

APPENDIX**Excerpts from Congressional Committee Reports re
Section 42 of the Revenue Act of 1934**

"Sections 42 and 43 of the Revenue Act of 1932 define the period in which items of income and of deduction shall be included.

"Your subcommittee recommends adding to the first of these sections a provision requiring the income-tax return of a decedent to include amounts of income accrued up to the date of his death, regardless of the fact that he may have kept his books on the cash basis. In the case of the second of these sections, a provision should be added allowing deductions to be likewise accrued.

"Since the courts have held that income accrued by a decedent prior to his death is not income to the estate, it follows that unless such income is taxable to the decedent it will escape income tax altogether. For the same reason, unless expenses which accrued prior to death are allowed to the decedent, they cannot be used. The recommendation made by the subcommittee remedies these defects." [Preliminary report of a subcommittee of the Committee on Ways and Means, 73rd Congress, 2nd Session, p. 15.]

"Sections 42 and 43. Income accrued and accrued deductions of decedents: The courts have held that income accrued by a decedent on the cash basis prior to his death is not income to the estate, and under the present law, unless such income is taxable to the decedent, it escapes income tax altogether. By the same reasoning, expenses accrued prior to death cannot be deducted by the estate. Section 42 has been drawn to require the inclusion in the income of a decedent of all amounts accrued up to the date of his death regardless of the fact that he may have kept his books on a cash basis. Section 43 has also been changed so that expenses accrued prior to the death of the decedent may be deducted." [Report No. 704 of the Committee on Ways and Means, 73rd Congress, 2nd Session, p. 24. Substantially the same language is used in the Report of the Senate Finance Committee, Report 558, p. 28.]

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1944

No. 534

ESTATE OF HENRY W. PUTNAM; GUARANTY
TRUST COMPANY OF NEW YORK, EXECUTOR,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

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October 31, 1944

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1944

ESTATE OF HENRY W. PUTNAM; GUAR-
ANTY TRUST COMPANY OF NEW YORK,
EXECUTOR,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 534

REPLY BRIEF FOR PETITIONER

**THE QUESTION PRESENTED BY THE PETITION IS OF
SUBSTANTIAL IMPORTANCE AND IS IN CONFLICT WITH
THE DECISION OF THE THIRD CIRCUIT IN THE *TAR
PRODUCTS* CASE.**

The decision in this case is in conflict with the decision of the Third Circuit Court of Appeals in the *Tar Products* case, 130 F. (2d) 866, and presents a question which is of substantial importance.¹

¹Issue is taken with one statement of fact made in the respondent's brief (p. 12) where it is said, "* * * if all other factors remained equal, the mere declaration of the dividend would have increased the market price for decedent's stock by the amount of the dividend." The declaration of a dividend usually has no effect on the market price of stock, as can be readily verified by examination of the quotations of the stock of principal corporations on the date of declaration. The declaration of a dividend is merely the transfer of corporate funds from one pocket to another. Before the divi-

If the decedent in the instant case had not died on March 30, 1938, but had on that date made an *inter vivos* transfer of the shares of stock in question to other persons, he clearly would not, under the rule of the *Tar Products* case, have been taxable upon the dividends subsequently paid to the holders of such stock, regardless of his basis of accounting. This would not have been true of the items of income involved in the *Enright* case, 312 U. S. 636, the principal one being earnings of the decedent which would have been taxable to him even if transferred *inter vivos*. *Lucas v. Earl*, 281 U. S. 111.

The *Tar Products* case, as stated by the respondent on page 7 of his brief, established that a dividend becomes income to a cash and an accrual basis taxpayer at the same

dend is declared, the stockholder is the owner of his *pro rata* share of the net worth of the corporation; after the dividend is declared, he owns no more and no less, the only difference being that the directors have decided that a portion of the assets shall be set apart and distributed to the shareholders at a later date (the payment date).

However, the situation is quite different on the record date. The universal rule of stock exchanges is that sales before the record date include the dividend and sales after the record date do not. On the record date, or the day before, to allow purchasers time to obtain delivery and make transfer on the books of the corporation, the stock sells ex-dividend. On that date, other factors being equal, the price of the stock will drop from the price of the previous day by the exact amount of the dividend. (That can be verified by reference to the quotations of any leading stock on the ex-dividend day and the previous day. The stock quotation tables do not show that drop as a decrease. For instance, if the stock closed at 100 one day and closed the next day, ex a dividend of \$5, at 95, the quotations would set forth a net change of zero. That can be verified by reference to any newspaper or other table of quotations.

time, i.e., not sooner than the payment date, and that both types of taxpayers are subject to the same criteria. Accordingly, the dividend is the income of the transferee of stock prior to the record date, and can never under any circumstances or on any basis of accounting be the income of the transferor.

The Circuit Court of Appeals for the Second Circuit in the instant case held that because the transfer of the stock from the decedent on March 30, 1938, was by reason of his death rather than by means of an *inter vivos* transfer, the dividends upon the stock suddenly became an item of income to him under Section 42. But Section 42 admittedly set up no new concept of income.

However, the respondent's position must be that the word "income" itself has a different meaning in Section 42 than elsewhere. And so, at pp. 6-7 of respondent's brief, the *Tar Products* case is sought to be distinguished on the ground that it applied a regulation:

"providing that a taxable distribution by a corporation should be included in the gross income of the distributees when the cash or other property is 'unqualifiedly made subject to their demands' ". [Italics ours]

But that is a definition of when a dividend becomes "income" for Federal income tax purposes. Neatly illustrative of the same point is foot-note 6 (Resp. br. p. 8):

"Section 115(a) of the Revenue Act of 1938, referred to by petitioner (pet. 13, 17), simply defines a dividend for income tax purposes". [Italics ours]

Section 42, first enacted in the Revenue Act of 1934, did not purport to set up any new concept of income ("for

income tax purposes"). As stated on page 5 of respondent's brief, its object was to require the inclusion "in the income" of a deceased taxpayer of amounts which have accrued up to the date of the decedent's death "regardless of the fact that the decedent may have kept his books on the cash basis." Presumably Section 42 has no application to a decedent on the accrual basis of accounting, and in the case of a cash basis decedent, does not purport to tax anything which is not the income of the decedent, *i.e.*, items which would be the income of the Estate, on all bases of accounting—whether cash or accrual.²

Under the rule of the *Tar Products* case the executors would be taxable upon the dividend, since it was their income.³ Conversely, the *Tar Products* case makes it clear that the dividends were not the income of the decedent.

It appears to be a fact that the Federal income tax laws have been in force for over thirty years without there being an authoritative decision by this Court as to when a dividend accrues. So far as we know, the *Tar Products* case is the only Circuit Court of Appeals case on the question (beside the instant case) which proceeds on the theory that a

²The Section taxes "amounts" accrued up to the date of death, and the Committee Reports cited in the Appendix to the Petition show that the expression means amounts "of income". No contention has ever been made that amounts which were not the decedent's income, such as gifts, would be taxable to him under Section 42.

³As pointed out on p. 14 of Petitioner's brief, *Bach v. Rothensies*, 124 F. (2d) 306, decided by the Third Circuit about a year before the *Tar Products* case, did not present the question of when a dividend accrued. It was assumed there that the dividends in question had accrued to the trustee-holder of the stock.

uniform Federal rule is controlling; and it was not decided until 1942.

The decisions of the Fourth and Fifth Circuits, cited at page 8 of respondent's brief and at page 15 of petitioner's brief, both proceed on the erroneous theory that State law governs,⁴ and hence are inconsistent in their rationale both with the decision below and with the *Tar Products* case. The confusion among the Circuits is evident from a reading of their opinions. Moreover, none of the cases involving decedents, except the instant case, has indicated that a dividend accrued differently for a decedent than for anyone else. If there be any reason for such a rule, it has yet to be stated.

It is respectfully submitted that this Court should grant the petition for certiorari and thereby settle the question whether a dividend can be income to taxpayers (regardless of the method of accounting to be used and regardless of the law of the State of incorporation) prior to the time that such dividend is, in the language of the Treasury Regulations, "unqualifiedly made subject to their demands".

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October 31, 1944

⁴The respondent's brief shows the same confusion, citing numerous State cases as to when a dividend becomes a debt, etc. (pp. 10-11). The State rules are not uniform, as shown by the Tax Court decision in this case.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1944

No. 534

ESTATE OF HENRY W. PUTNAM; GUARANTY
TRUST COMPANY OF NEW YORK, Executor,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

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January 6, 1945.

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 534

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

Opinions Below

The opinion of the United States Board of Tax Appeals (now The Tax Court of the United States) is reported at 45 B. T. A. 517 (R. 20-25). The opinions of the Circuit Court of Appeals (majority opinion by Judge Thomas W. Swan, R. 40, dissenting opinion by Judge Learned Hand, R. 44) are reported at 144 F. (2d) 756.

Jurisdiction

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, 28 U. S. C., § 347(a)).

The order, judgment and decree of the Circuit Court of Appeals for the Second Circuit was entered on August 25, 1944 (R. 46). Petition for certiorari was filed on October 2, 1944, and granted on November 13, 1944 (R. 47).

Question Presented

Under the Revenue Act of 1938, should a corporate dividend upon shares owned by a decedent, which was declared payable to holders of record on a date subsequent to his death, be treated as (1) income accrued to him during his lifetime, or (2) income accrued to the shareholder who became on the record date entitled to receive it or on the payment date received it?

The Statute

The case is controlled by the Revenue Act of 1938 (52 Stat. 447), the pertinent provisions of which are the familiar definition of gross income in § 22(a), which includes "dividends", and the following:

"SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

"(a) Definition of dividend.—The term 'dividend' when used in this title (except in section 203(a)(3) and section 207(c)(1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made."

"SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

"The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period."

Statement

Henry W. Putnam died on March 30, 1938, owning, among other investments, shares in

General Motors Corporation* and United Profit Sharing Corporation,* both Delaware corporations;

American Can Company, American Smelting & Refining Company and Hecker Products Corporation, all New Jersey corporations;

Westinghouse Air-Brake Manufacturing Company and Philadelphia Company, both Pennsylvania corporations; and

United States Smelting, Refining & Mining Company,* a Maine corporation (R. 22-23).

All of these corporations had made dividend declarations prior to the date of his death. In every case, however, the dividend was to be paid only to holders of record on

*Preferred stock.

designated dates, all of which dates were subsequent to the date of his death (in one case, six months later). In every case also the payment date was to be subsequent to the record date, in most cases one month subsequent to the record date (R. 22-23).

On the date of death, therefore, there had not yet accrued to the decedent any right to receive any of the dividends.

The Commissioner assessed income tax on the dividends both to the decedent (R. 16) and to his Estate (R. 8), so as to insure collection of income tax either as of the date of declaration or as of the record date or payment date. The Executor recognized the obligation of the Estate to pay the tax, as the Estate still held the shares in question on the record and payment dates. It disputed, however, the power of the Commissioner to impute the same income to the decedent during his lifetime.

The Commissioner's doubt was evidently whether under § 42 of the Revenue Act of 1938, 52 Stat. 447, the dividend had accrued to the decedent, the relevant provision being that

“* * * In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period.”

The taxpayer's position was that income could not be said to have accrued prior to death, for the dividends had not been declared payable to the decedent, but only to such stockholders as should be on the books on a subsequent date. A dividend declared payable to holders on a subsequent record date confers no rights upon present holders, and hence

could not constitute income to such holders under Section 22(a) of said Revenue Act.

The Tax Court,¹ considering itself bound by the 4th Circuit Court of Appeals' decision in *Helvering v. McGlue's Estate*, 119 F. (2d) 167 to apply the law of the State of incorporation as to the date upon which a dividend became "a debt", upheld the assessment to the decedent in the cases of the New Jersey corporations and the assessment to the Estate in the cases of the Delaware, Pennsylvania, and Maine corporations.²

The decedent's income for the portion of the year 1938 prior to the death was in higher brackets than the Estate's income for the balance of the year,³ and accordingly there followed cross-appeals to the 2d Circuit Court of Appeals.

The majority of the 2d Circuit Court of Appeals (Swan and Chase, JJ.) held (1) that the case called for the application of a uniform Federal rule, and (2) that the rule should be that a dividend accrues for the purposes of §42 as soon as declared. The Tax Court's decisions as to the tax liability of the decedent and the Estate were reversed and remanded "with directions to accrue the dividends to the decedent and determine the decedent's deficiency and the estate's overpayment accordingly" (R. 46).

¹The case was heard and decided while the Tax Court was still known as the Board of Tax Appeals.

²In its own decision in *McGlue's Estate*, 41 B.T.A. 1186, the Tax Court had evidently assumed that the question of the date of accrual for income tax purpose of a corporate dividend called for a uniform Federal rule. In this it was reversed by the 4th Circuit Court of Appeals,—erroneously (as both the majority and dissenting Judges of the Court below, and both the Commissioner and we ourselves, all agree; cf. *Lyeth v. Hoey*, 305 U. S. 188).

³This was because the Estate distributed substantially all of its income, which thus became taxable to the various distributees.

Judge Learned Hand dissented. He agreed that the case called for the application of a uniform Federal rule, but he pointed out that no date prior to the record date could be determinative, for at the date of death it was still undetermined whether the decedent would have received income at all.

Specification of Errors to be Urged

The Circuit Court of Appeals erred:

1. In failing to hold that there was an overpayment of \$13,576.95 in the decedent's income tax for the taxable period ending March 30, 1938, the date of his death.
2. In holding that the corporate dividends accrued to the decedent on the dates such dividends were declared and thus prior to his death.

Summary of Argument

§ 115 of the Revenue Law and Art. 115 of the Regulations prescribe the date of receipt as determinative of income from a corporate dividend. *Tar Products Corporation v. Commissioner*, 3rd Circ., 130 F. (2d) 866, has applied that rule to a taxpayer on the accrual basis. And under § 42 of the Revenue Act of 1938, applicable in this case, the accrual date is to govern. At least, the accrual date cannot be earlier than the record date. Stock Exchange and general financial practice indicate that this is the true rule. The theory of such decisions as there have been in this Court is consistent therewith. And it is the reasonable result of a fair interpretation of the statute on its face.

ARGUMENT

I.

The Court below erred in holding that a dividend accrues on the declaration date.

(1) A dividend cannot accrue to a person until the right to receive it has accrued to him.

Both the majority and dissenting judges of the Court below, and both the Commissioner and the taxpayer in the Court below, agreed that the question (as to the date when a dividend accrues) calls for the application of a uniform Federal rule, and not a consideration of the local law of the State in which the corporation declaring the dividend is incorporated.⁴ The Court, however, erred in determining what that uniform Federal rule was. The majority opinion is to the effect that a dividend accrues on the declaration date.

What we argued below, and what Judge Learned Hand has pointed out in his dissenting opinion, is that under the modern record date practice there is no stockholder who can make a claim to be entitled to a dividend upon the ground that he held the stock on the mere date of declaration. Judge Learned Hand said:

⁴As showing the confusion in which this question has been shrouded, reference is made to *Helvering v. McGlue's Estate*, 119 F. (2d) 167 (C. C. A. 4); *Commissioner v. Cohen*, 121 F. (2d) 348 (C. C. A. 5); and the decision of the Tax Court in the instant case, all holding that local law governs. For a more detailed history of this confusion, the Court is respectfully referred to our brief in support of petition for certiorari, at pp. 8-9 and 15-17.

"The confusion lies in the fact of treating the certainty that there is a debt as a certainty of the identity of the creditor."

Each one of the eight corporations in this case had declared a dividend and would owe a debt; but prior to the record date it was not known to whom the debt would be due and payable,—who would realize income from it,—to whom such income would accrue.

Judge Learned Hand further pointed out the distinction between the question in the present case and the question in *Helvering v. Enright*, 312 U. S. 636:

"* * * it is one thing to hold that one should compute the present value of all the items of unfinished work on a lawyer's books, even though there is a chance of error in doing so because some of the charges are contingent; they have a present value, which ordinarily can be approximately computed. But it is quite another thing, when the very obligee of a claim remains undetermined, arbitrarily to select one of the two or more possible persons who may become the obligee, and say that one will treat him as the owner of the claim."

It seems entirely reasonable that a dividend should be held not to accrue to a person until the right to receive that dividend has accrued to him. As this Court said, in *Spring City Foundry Co. v. Commissioner*, 292 U. S. 182, 184:

"Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the *right to receive* and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues. * * *"
[Emphasis ours.]

(2) The statute and regulation which define a "dividend" are to the effect that a distribution is made only when it becomes subject to the recipient's demand.

Section 115(a) of the Revenue Act of 1938 defines a "dividend" as "any distribution made by a corporation to its shareholders" out of its earnings or profits. This must mean that there can be no "dividend" until a *distribution* has been *made* "by a corporation to its shareholders". The statutory provision is accordingly irreconcilable with the holding below that a dividend can be income on the declaration date.

A Treasury Regulation of long standing (with respect to the Revenue Act of 1938 contained in Article 115-1 of Treasury Regulations 101) further provides:

"A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands."

The statute, § 115(a), and the regulation, Art. 115-1, were construed in *Avery v. Commissioner*, 292 U. S. 210, to mean the date of actual receipt of the dividend by the taxpayer; and that construction was applied by the 3rd Circuit to taxpayers on an accrual basis in *Tar Products Corp. v. Commissioner*, 130 F. (2d) 866. The Commissioner did not apply for a writ of certiorari in the *Tar Products* case.

As is pointed out in Judge Goodrich's opinion in the *Tar Products* case, there are good reasons why the treatment of dividends as income should be subject to a single

rule, regardless of the bookkeeping methods of the taxpayers,⁵ *e.g.* (1) the single rule enables taxpayers' returns to be checked against the corporation's record of disbursement; (2) the single rule prevents variations in the case of dividends paid in kind where the value of the property fluctuates.

A third good reason for a uniform rule might be that a "dividend", in order to be a taxable dividend rather than a return of capital, must be paid out of the earnings or profits of the corporation, § 115(a), and that the date for determining the amount of earnings or profits available to pay a dividend is uniformly the date of payment, rather than the date of declaration. See *Mason v. Routzahn*, 275 U. S. 175; *Commissioner v. James*, 49 F. (2d) 707 (C. C. A. 2d 1931); Paul, "Selected Studies in Federal Taxation (Second Series)", p. 154. Thus, if we suppose a "dividend" that had been declared on December 15, 1938, payable on March 31, 1939, to stockholders of record February 28, 1939, and that the declaring corporation had no earnings in 1938⁶ but did have in 1939 earnings sufficient to pay the dividend, then (1) if the rule be that it becomes a dividend for income tax purposes only at the date of pay-

⁵Whether there is a distinction between accrual and cash basis taxpayers, or whether both become liable only upon receipt of payment, need not, however, be finally decided in this case. The former may become liable upon the record or "ex-dividend" date, although the latter would not become liable until the receipt of payment. The day on which the stock sells "ex-dividend" on the Stock Exchange is customarily the day preceding the "record" date set by the directors.

⁶It is assumed that the corporation had no accumulation of earnings prior to 1938 but that it did have sufficient paid-in surplus out of which a dividend could legally be declared for purposes of the general corporate law.

ment (as we contend), then cash basis and accrual basis taxpayers will be treated alike and taxed upon the same amount; but (2) if the rule be as announced by the Court below, the "dividend" would be a return of capital for accrual basis taxpayers and a taxable dividend for cash basis taxpayers.

The Tax Court itself now follows the *Tar Products* case as a rule of accounting convenience. In *American Light and Traction Company*, 3 T. C. 1048, 1050 (1944), it stated:

"* * * We have given careful consideration to the respondent's argument, our opinion and that of the Circuit Court of Appeals. We are convinced that the importance of the question lies in the promptness and certainty of the answer. Therefore, without discussing the relative merits of the opinion of the Circuit Court of Appeals and our own, we yield to the former. Moreover, the decision of the Third Circuit Court of Appeals in the *Tar Products* case has been cited with apparent approval by the Circuit Court of Appeals for the Fourth Circuit in *Helvering v. Kaufmann et al.*, 136 Fed. (2d) 356 * * *."

(3) The mere declaration of a dividend does not, either in theory or practice, affect the value of a stock.

(i) INTRODUCTORY

We submit these business considerations, not because the Courts exercise any fact-finding function in tax cases, but to aid the Court in determining what ought to be the uniform interpretation of the tax statute.

(ii) THEORY

Before the dividend is declared, the stockholder is the owner of his *pro rata* share of the net worth of the corporation; after the dividend is declared, he owns no more and no less, the only difference being that the directors have decided that a portion of the assets shall be set apart and distributed to the stockholders at a later date (the payment date). The only effect the declaration could have would be the psychological one on prices if the dividend were unexpected and called the attention of the market to the favorable earnings or position of the company. That such an effect is at least rare, and should not therefore be the basis of a rule in our modern industrial civilization, is indicated by the experience of the dividends involved in the instant case.

(iii) PRACTICE

Taking merely as examples two of the major stocks in this case, in both of which there is widespread trading,—one a common stock (Westinghouse Air Brake), the other a preferred stock (General Motors),—we find that the dividend declarations involved in the present case resulted in no change in value. The examples are given in Appendix B. We have checked the other dividend declarations involved in the present case, and found similar results.

However, the situation is quite different on the record date. The universal rule of stock exchanges is that sales before the record date include the dividend and that sales after the record date do not. On the day before the record date, to allow purchasers time to obtain delivery and make the transfer on the books of the corporation, the stock sells

ex-dividend. On this date, other factors being equal, the price of a stock will drop from the price of the previous day by the exact amount of the dividend. The following quotations are uniform in describing the lessons of daily financial experience:

Dice & Eiteman, The Stock Market (1941):

"On the day on which a stock is sold ex-dividend the opening, if nothing of importance has happened since the previous day's close, will be lower than the previous close by the amount of the dividend * * *"
(p. 48).

Preinreich, Gabriel A. D., The Nature of Dividends (1935):

"* * * the opening price of a stock on the ex-dividend date, in normal times, is equal to the last closing price minus the dividend which is no longer included" (p. 47).

Schabacker, Stock Market Theory and Practice (1930):

"For on this ex-dividend date for any stock, the market price of that issue theoretically drops the amount of its dividend. If the stock closed at 110 the day before it goes ex-dividend, and the amount of the dividend to be paid is \$10, then theoretically the opening price the next morning, on the ex-dividend date, would be only 100. * * * In practice, of course, the decline is not always exactly the amount of the dividend, depending upon the ordinary action of supply and demand for the stock in question. But such stock would almost certainly drop approximately the amount of the dividend which it went 'ex'
(p. 353).

* * * * *

"The market price of a stock on which rights to subscribe have been declared drops theoretically, and usually in a practical manner, just the value of the right declared, on the date when the stock goes 'ex-rights,' just as we have seen that a stock drops the value of its cash dividend, or its stock dividend, on the day when the stock goes 'ex-dividend'" (p. 368).

Armstrong, The Book of the Stock Exchange (1934):

"On the day that a security is quoted 'ex'-dividend, the approximate value of the dividend is deducted from the market price. The specific date of such deduction has the immediate effect of settling to whom the dividend belongs" (p. 270).

Grange, Corporation Law for Officers and Directors (1935):

"On that day [ex-dividend day] the stock is said to become 'ex-dividend' and there is usually a small drop in its market price to compensate for the loss of the dividend which has been cut off, so to speak, from the stock" (pp. 262-3).

We suggest that this Court will find the following excerpt from Mr. Justice Pitney's opinion in *United States v. Phellis*, 257 U. S. 156-176,⁷ to be still practical economic good sense and sound income tax law, *a fortiori* applicable to a successor to ownership of shares on which a dividend has been declared but for which the record and 'ex-dividend' dates have not yet occurred:

"Where, as in this case, the dividend constitutes a distribution of profits accumulated during an ex-

⁷Justices McReynolds and Van Devanter dissenting.

tended period and bears a large proportion to the par value of the stock, if an investor happened to buy stock shortly before the dividend, paying a price enhanced by an estimate of the capital plus the surplus of the company, and after distribution of the surplus, with corresponding reduction in the intrinsic and market value of the shares, he were called upon to pay a tax upon the dividend received, it might look in his case like a tax upon his capital. But it is only apparently so. In buying at a price that reflected the accumulated profits, he of course acquired as a part of the valuable rights purchased the prospect of a dividend from the accumulations—bought 'dividend on,' as the phrase goes—and necessarily took subject to the burden of the income tax proper to be assessed against him by reason of the dividend if and when made. He simply stepped into the shoes, in this as in other respects, of the stockholder whose shares he acquired, and presumably the prospect of a dividend influenced the price paid, and was discounted by the prospect of an income tax to be paid thereon. In short, the question whether a dividend made out of company profits constitutes income of the stockholder is not affected by antecedent transfers of the stock from hand to hand" (pp. 171-172).

II.

A dividend does not accrue differently to a decedent than to anyone else.

(1) The dividend case is not within the mischief aimed at by §42 of the Revenue Act of 1938.

Section 42 was designed to cure the avoidance of tax which resulted from decisions, of which *Nichols v. United*

States, 64 Ct. Cls. 241 provided an example, in which income accrued during the lifetime of a decedent who was on a cash basis was held not to be income either to him or to his estate.⁸ This would be particularly applicable to earnings, as earnings necessarily represent the reward of labor by the decedent during his lifetime; *cf. Lucas v. Earl*, 281 U. S. 111. It would also be applicable to items accruing over regularly spaced periods of time, such as quarterly or annual taxes, rentals and the like; *Enright's case*, 312 U. S. at p. 643. It would *not* be applicable to dividends, whose declaration is entirely within the discretion of the Board of Directors governed by the exercise of the directors' judgment as to the condition of the corporation.

Accordingly, in this case, the Commissioner has done what Congress recognized that he could not do in the type of case for which § 42 was provided. He has assessed the Estate. He has himself thus ruled that the income did accrue from the dividend to the estate after the death. This assessment is not disputed by the Executor. Hence, the evil which § 42 was designed to correct does not exist in this case. The Commissioner has no occasion to resort to § 42 to collect the income tax which is properly due on the dividends.

None of the cases involving § 42, except the instant case, has indicated that a dividend accrues differently for a decedent than for anyone else. If there be any reason for such a ruling, it has yet to be stated.

⁸For the convenience of the Court, those portions of the Congressional reports dealing with §42 of the Revenue Act of 1934 (the same as §42 of the Revenue Act of 1938) are included as Appendix A to this brief.

(2) The dividend case is not within the rationale of *Helvering v. Enright*, 312 U. S. 636.

A paragraph of this Court's opinion in the *Enright* case, at pages 644-645, has been supposed by the Court below to justify it in not giving an independent analysis of the dividend question on the merits. The paragraph in question, 312 U. S. at 644-645, concluded:

"Accruals here are to be construed in furtherance of the intent of Congress to cover into income the assets of decedents, *earned* during their life and unreported as income, which on a cash return, would appear in the estate returns. *Congress sought a fair reflection of income.*" (Italics ours.)

This Court further stated (at p. 642) that the question was whether the earnings in that case constituted "an accrual of income" and concluded that they were taxable *because* they were "properly" accrued. This constituted a decision, in conformity to the statute, that the question is in each type of case whether income has in fact *properly* "accrued".

The opinion further pointed out "That the meaning to be attributed to 'accrued' as used in § 42 is to be gathered from its surroundings" (at p. 644). The appropriate "surroundings" in the present case may be found in §115 of the Revenue Act of 1938; and §115 provides the definition, in terms applicable throughout the Act, of a "dividend" as a corporate distribution when "made". Thus, the question under §42 becomes: When was the dividend made to the taxpayer?

We understand that the true construction of this Court's position in the *Enright* case is to be found in its holding at

page 643 that (1) "accrued" had *not* become a "word of art" under the Income Tax Act, and therefore that (2) its meaning under §42 was open to objective interpretation in each case, unfettered by reference to broader interpretations under other sections, specifically (in that case) under § 48 of the Revenue Act of 1934. We understand that this Court was merely disclaiming any slavish adherence to the formula of statutory interpretation that a given word must always have the precisely same meaning wherever it appears in a statute, regardless of its context. We are further confident that this Court did not mean to be understood as saying that the desirability of raising revenue from decedents in itself creates a rule of interpretation, carrying as a consequence that income is to be imputed to decedents under § 42 which would not under other sections be income at all.

The critical question remains: When may a corporate dividend be held to have "*properly accrued*"? The learned Court below was in error in supposing that this Court intended in the *Enright* case to dispense with the duty of construing the governing word employed by Congress—"accrue".

This case is different in all vital respects from *Enright's*

(1) As to the *factual* basis of the cases: whereas earnings may fairly be said to have necessarily accrued during the lifetime of the individual who earned them, no such consideration applies to dividends until they become payable to the stockholder.

(2) As to the theory of statutory interpretation: whereas there was no other section of statute providing

material aid to the interpretation of the word "earnings", Section 115(a) does require to be considered where dividends are involved.

(3) As to the practical results: whereas a decision adverse to the Government in *Enright's* case would have meant that no income tax was payable, as it was understood that the earnings could not in any event be income to the Estate, there was in this case an assessment of the same income to the Estate itself.

The assessment to the Estate has added significance, in that it reflects the doubt of the Commissioner himself that the income had truly "accrued" before the death, even under a "broad" interpretation of the word.

The leading earlier case on the meaning of "accrue" was doubtless *United States v. Anderson*, 269 U. S. 422. This case was the first in this Court that recognized and applied the privilege, first provided in the 1916 Act, that taxpayers' accounts might be kept on an accrual basis. Argued by Mr. Solicitor General Mitchell for the Government and by Mr. John W. Davis for the taxpayer in 1925, the opinion was rendered by the present Chief Justice, with Mr. Justice Sutherland and Mr. Justice Sanford dissenting. The sole question was as to the meaning of "accrual"; and the opinion for this Court after reviewing the arguments of the distinguished counsel before it, concluded that "accrual" occurs when the liability of the taxpayer is determined, and all the events have occurred which fix the amount.

The determination of the taxpayer to whom the dividend is to be paid cannot be made until the record date. Until

that date, one does not know who the recipient is to be. Whatever be the correct theory as to the date upon which a tax accrues, it cannot be before the date when it is known who the taxpayer is to be.

Respectfully submitted,

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January 6, 1945.

APPENDIX A**Excerpts from Congressional Committee Reports re
Section 42 of the Revenue Act of 1934**

"Sections 42 and 43 of the Revenue Act of 1932 define the period in which items of income and of deduction shall be included.

"Your subcommittee recommends adding to the first of these sections a provision requiring the income-tax return of a decedent to include amounts of income accrued up to the date of his death, regardless of the fact that he may have kept his books on the cash basis. In the case of the second of these sections, a provision should be added allowing deductions to be likewise accrued.

"Since the courts have held that income accrued by a decedent prior to his death is not income to the estate, it follows that unless such income is taxable to the decedent it will escape income tax altogether. For the same reason, unless expenses which accrued prior to death are allowed to the decedent, they cannot be used. The recommendation made by the subcommittee remedies these defects." [Preliminary report of a subcommittee of the Committee on Ways and Means, 73rd Congress., 2nd Session, p. 15.]

"Sections 42 and 43. Income accrued and accrued deductions of decedents: The courts have held that income accrued by a decedent on the cash basis prior to his death is not income to the estate, and under the present law, unless such income is taxable to the decedent, it escapes income tax altogether. By the same reasoning, expenses accrued prior to death cannot be deducted by the estate. Section 42 has been drawn to require the inclusion in the income of a decedent of all amounts accrued up to the date of his death regardless of the fact that he may have kept his books on a cash basis. Section 43 has also been changed so that expenses accrued prior to the death of the decedent may be deducted." [Report No. 704 of the Committee on Ways and Means, 73rd Congress, 2nd Session, p. 24. Substantially the same language is used in the Report of the Senate Finance Committee, Report 558, p. 28.]

APPENDIX B

Westinghouse Air Brake Mfg. Co. (Common)

Dividends of 25¢ per share declared on November 16, 1937, payable on April 30, 1938, July 30, 1938 and October 31, 1938, to stockholders of record on March 31, 1938, June 30, 1938 and September 30, 1938, respectively (Record, p. 6).

	November	Open	High	Low	Close	Chgs.
	12	27	29	26½	29	+1
	13	28	28	28	28	-1
	15	28¼	29	28	28	..
D	16	27	27½	26⅞	27	-1 D
	17	26⅞	28	26⅞	27¼	+ ¼
	18	27	27¾	26⅞	26⅞	- ⅜
	19	27	27	25	25	-1⅞
	20	25	26	24⅞	26	+1

General Motors Corp. (\$5 Preferred)

Dividend of \$1.25 per share declared on February 7, 1938, payable on May 2, 1938, to stockholders of record on April 4, 1938 (Record, p. 6).

	February	Open	High	Low	Close	Chgs.
	1	115	115	114⅝	114⅝	- ⅜
	2	114⅜	114⅜	113½	113½	-1⅞
	3					No trading
	4	114	114	114	114	+ ½
	5	113¾	114	113¾	114	0
D	7					No trading.
	8	114	114	114	114	0
	9	114	114	114	114	0
	10	114	114	114	114	0
	11	114	114⅞	113⅞	114⅞	+ ⅞

D indicates date upon which dividend was declared.

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CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No. 534

ESTATE OF HENRY W. PUTNAM: GUARANTY
TRUST COMPANY OF NEW YORK, Executor,
Petitioner,
against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF FOR PETITIONER

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January 30, 1945.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1944

ESTATE OF HENRY W. PUTNAM: GUAR-
ANTY TRUST COMPANY OF NEW YORK,
Executor,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petitioner,

No. 534

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF FOR THE PETITIONER

(I) SUMMARIZED RESTATEMENT OF THE ISSUE.

The respondent's brief skillfully avoids the critical
issue:

Is the statute to be interpreted as imposing a tax
before there is a taxpayer? Was there income at all
in this case to be taxed?

This was the issue on which Judge Learned Hand based
his conclusion adverse to the respondent. It was avoided
by the majority opinion, which relied on authority—the
Enright case, which applied § 42 to income from personal

services, and decisions of lower Courts in which no *reasoning* had been attempted. We have covered in our opening brief why these authorities do not suffice to resolve this issue.

Let it be agreed that the Congress has constitutional power to impose a tax on the *probability* or *expectation* of receiving income, although never received. Such an exercise of the taxing power must at least be the exception, not the rule. The Court below suggests no reason to impute such an intention to the Congress in this case.

The principal arguments suggested by the respondent are:

(a) That this case is within the evil aimed at by the Congress;

(b) That a dividend is to be assimilated to earnings;

(c) That a dividend is paid out of earnings or profits of the corporation prior to declaration;

(d) That the decedent had a "fixed right" to the dividends.

(a) This case is not within the mischief aimed at by § 42.

That mischief was avoidance of tax, as in cases where income earned during life was held not to be income to the estate, *e.g.* *Nichols v. U. S.*, 64 Ct. Cls. 241; whereas in the case of a dividend income tax *will* be payable by the estate. The dividends here will not (to use the language of the Committee Reports) "escape income tax altogether."

(b) A dividend is of a different character from earnings for personal services.

Earnings for personal services accrue directly to the earner; indeed, as to earnings the usual revenue avoidance problem, if any, arises out of the effort by the earner to short-circuit the Treasury by routing the income direct to a third party. Dividends on the other hand, are from earnings of the corporation, not of the recipient.

(c) Questions as to the earnings and profits of the corporation itself are irrelevant.

For the purposes of income tax law, the nature and source of a dividend is settled by § 115 and the appropriate regulations thereunder. Thus, § 115(b) of the Revenue Act of 1938 states that "every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits." Accordingly, a dividend may be paid from amounts earned after the declaration date (*i.e.*, between the declaration and payment dates, or even to the end of the taxable year of payment, § 115(a)(2)). Indeed, in the case of every corporation that earns anything after the declaration date, the dividend would be paid at least in part from earnings realized after that date.

The fallacy is to confuse the proper accounting rule for the corporation with the income tax status of the shareholder.

If the position of the respondent—that the taxing of the shareholder is a result of the earning by the corporation—were sound, it would tax to the decedent on the date of his death his *pro rata* share of the earnings of every corporation in which he held stock. The respondent certainly does not contend for any such rule; but his

persistence in citing as if relevant the rule of local corporate law that it is on the declaration date that the corporation becomes "indebted", *i.e.* must enter the dividend as a liability (*e.g.* his brief p. 17, also p. 13 note 5 and p. 14 note 6, and p. 20) illustrates his confusion (and the confusion of the lower Federal Courts which had supposed that consideration to be governing, *e.g. McGlue's Estate*, 119 F. (2d) 167).*

There was no independent "economic benefit" to the decedent upon declaration of the dividend. He received no warrant, scrip or other sort of disposable right. Before the declaration the share of stock carried its pro rata right to "share" in all earnings of the corporation; and after the declaration it was salable only as a unit, inclusive of the same right. What the respondent calls (at p. 15) "the severance of the amount of the dividend from the general equity interest of the stockholders in the corporate assets" takes place only within the corporation's accounts, and thus again illustrates the persistent confusion in respondent's view.

(d) The decedent never had a "fixed right" to the dividends.

It is a double misnomer for respondent to refer (at p. 16) to the decedent as having a right "to receive money at a fixed present time" and then to call that a "fixed right".

*It is significant that of the cases which respondent purports to cite (in footnote 9 on p. 19) as holding that a dividend "vests" in the stockholder on the declaration date, decisions of State Courts (which alone can be governing under *Erie R. R. Co. v. Tompkins* 304 U. S. 64) are found only in New Jersey and New York, and it is recognized that the New York rule may have been changed to conform to the weight of authority and (to us) the true rule.

It is no answer to say, as the respondent's brief does (pp. 6, 25), that the decedent should be taxable on the dividends as soon as declared, since it was in his power to hold the stocks until the record date and receive the dividend. That argument would apply *a fortiori* to a living taxpayer. It would *not* be applicable to a taxpayer who died before the record date.

(II) REPLY TO OTHER ARGUMENTS ADVANCED BY THE RESPONDENT.

(a) The respondent's references to statutory provisions and regulations are not relevant.

(i) Statutory history.

A dividend was first defined in the Revenue Act of 1916 (39 Stat. 756). § 2(a) defined a dividend as "any distribution made or ordered to be made by a corporation * * * out of its earnings or profits * * * and payable to its shareholders * * *". [Emphasis ours.]

The Revenue Act of 1917 (40 Stat. 300) contained in § 1211 the same definition of dividend as was contained in the 1916 Act, but added the provision that any

"distribution made to the shareholders * * * in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the *distributec* for the year in which *received* and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation * * *". [Emphasis ours]

The Revenue Act of 1918 (40 Stat. 1057) was the first to adopt the familiar definition of dividend now contained in § 115. § 201 of the 1918 Act defined a dividend as "any distribution *made* by a corporation * * * to its shareholders * * * out of its earnings or profits accumulated since February 28, 1913 * * *". [Emphasis ours] In the light of the previous wording of the definition in prior Acts, the use of the term "distribution *made*", while omitting the phrase "distribution * * * *ordered to be made*", represents a Congressional direction that a dividend had to be distributed before it could be income.

In addition, the 1917 Act, although specially providing that a dividend could be taxed only in the year in which received, had taxed that dividend at the rates in force during the years in which it was earned and not the rates in force during the year of receipt. The 1918 Act established the rule that the tax rates in force during the year of *receipt* should control. The Ways and Means Committee Report on the 1918 Act (65th Cong., 2d Sess., H. R. No. 767, pp. 3-4) makes this abundantly clear. It states:

"* * * The present law [*i.e.*, the 1917 Act] provides that dividends distributed to the stockholder shall be taxable to the individual at the income tax rates in effect in the year in which the dividend is received, unless the corporation distributes more than its earnings for the taxable year, in which case the additional amounts so distributed are taxable in the hands of the individual at the rates in effect during the year in which the corporation earned the same. Under the proposed bill all distribution of earnings accrued since February 28, 1913, will be taxable in the hands of the stockholder according to the rates in effect during the year in which the dividend is received.* * *

And this Court has already held that the phrase "distribution made" refers to the date of receipt of the dividend. In *Mason v. Routzahn*, 275 U. S. 175, Mr. Justice Brandeis, for a unanimous Court, said (at p. 178) :

"Since two of the dividends paid in 1917 were declared in 1916, it becomes necessary for us to consider whether these also are to be deemed *distributions made* in 1917, as it is only to such that the section applies. It declares that the dividend is income of the shareholders in the year in which it is 'received'. We think it clear that, for this purpose, the date of payment, not the date of the declaration of the dividend, is the date of distribution; and as all the dividends here in question were paid in 1917, the provision as to the rate is applicable to all."
[Emphasis ours]

An example may illustrate why a single rule taxing all shareholders (regardless of the basis of accounting) on the date of receipt of the dividend is the only workable one :

Suppose that Corporation A, on the accrual basis, owns shares in another corporation. A dividend on those shares is declared on February 1, payable on March 15 to shareholders of record on February 15. Then suppose that Corporation A sells the shares to Taxpayer B, who is on the cash basis. Taxpayer B holds the shares on both the record and the payment dates and receives the dividend. If a dividend "accrues" on the declaration date, Corporation A is taxable on the dividend because it is on the accrual basis. On the other hand, Taxpayer B, who is on the cash basis and has received the dividend, is also taxable thereon. It is no defense for him to say that the price he paid for the stock reflected the value of the dividend. See *U. S. v.*

Phellis, 257 U. S. 156, 176, discussed at pp. 14-15 of our opening brief.

Other absurdities consequent upon the respondent's view may be considered:

Judge Learned Hand in the dissenting opinion below pointed out that a rule that a dividend "accrued" on the declaration date would, when applied to sales of stock by a decedent prior to his death, lead to preposterous results. The respondent attempts to meet that argument by stating (p. 22) that "there would be no occasion to apply Section 42 if the decedent had sold his stock prior to his death." The wording of § 42 does not support the respondent's position. It applies to all items "accrued" during the entire taxable period ending with the decedent's death (in this case January 1, 1938 to March 30, 1938) *or any prior period*. If a dividend "accrues" on the declaration date, there is nothing in § 42 which would relieve the decedent from the income tax thereon because he had disposed of the shares prior to the record date and the new shareholder was also taxed on the dividend.

(ii) *The Treasury Regulations*

The respondent's brief states (p. 27) that the wording of the Treasury Regulation that a "taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands" was originally contained in § 201(e) of the Revenue Act of 1921, but was omitted (as a statutory provision) in subsequent revenue acts. That the Treasury Regulation has been continued without change, shows that the omission of the statutory provision was not intended to change the law.

The decedent in the instant case was *not* the "distributee" which the Treasury Regulations say is to be taxed.

~~The estate was.~~

Article 13 of the Estate Tax Regulations (Treasury Regulations 80), cited at pages 23 and 23 of the respondent's brief, in so far as it is relevant at all, supports the petitioner's position. It provides that "dividends both declared and payable to holders of record on a date prior to the valuation date [date of death], should be separately included" in the gross estate *provided* the stock is valued "ex-dividend" on the valuation date [date of death]. In other words, a dividend will not be considered as a dividend until the record date. As the Circuit Court of Appeals for the Third Circuit said, in *Sharp v. Commissioner*, 91 F. (2d) 802, 803:

"Valuation of the estate assets is the same whether the stock is valued with the dividend or is valued ex-dividend and the dividend debt value is added."

Nor does the quotation from the Conference Committee Report on the 1934 Revenue Bill (referred to at pp. 9 and 10 of the respondent's brief) indicate *when* a dividend accrues. The Report merely states that the decedent would be entitled to a credit, in computing the normal tax, with respect to accrued items "such as dividends". That credit was eliminated in the 1936 Act and was not applicable to the decedent here. The statement in the Report is wholly consistent with the rule that a dividend accrues on either the record date or the payment date, both of which would be prior to the date upon which a cash basis taxpayer would be required to take the dividend into income.

(b) In enacting § 42 the Congress gave no evidence of intent to include items (such as dividends) which under existing law would become income after, but not until after, the death.

§ 22(a) says that "dividends" are income. § 115(a) defines a dividend as a "distribution made by a corporation to its shareholders". The Treasury Regulations have said for many years that a dividend shall not be included in income of the distributees until the "cash or other property is unqualifiedly made subject to their demands." This Court, in *Avery v. Commissioner*, 292 U. S. 210, settled that time to be the date of actual receipt of the dividend check.

A dividend, therefore, is just not "income" to anyone within the meaning of the revenue acts until the distribution has been made.

Nor is there any indication that the Congress, in enacting § 42, thought that a dividend was not taxable in the return of the estate where the record date was after the decedent's death. *William K. Vanderbilt*, 11 B. T. A. 291 (1928) and *Frank H. Clark*, 12 B. T. A. 425 (1928) (cited at pp. 8 and 9 of the Commissioner's brief) did not so hold. In the *Vanderbilt* case it does not appear whether the record date was before or after death. In the *Clark* case it appears that the record date was prior to death. Indeed, as the Commissioner points out (at p. 12 of his brief), the Circuit Court of Appeals for the Third Circuit, in *Sharp v. Commissioner*, 91 F. (2d) 802, held that a dividend declared prior to the decedent's death was taxable as income of the estate where the record date was after death. The Commissioner has followed that principle in making his assessment to the estate in this case.

And the Third Circuit Court of Appeals, in the *Tar Products* case, 130 F. (2d) 866, applied the rule of the *Avery* case, 292 U. S. 210, *supra*, to an accrual basis taxpayer. The respondent's brief (pp. 27-28) evades the issue whether the rule of the *Tar Products* case is right or not. Respondent does seem to agree that a dividend becomes income at the same time to cash and to accrual basis taxpayers. He draws the conclusion from that statement that the *Tar Products* case did not decide when the dividend "accrued", even though the taxpayer there involved was on the accrual basis of accounting. That is of course meaningless. What the respondent's reasoning comes down to, is that the *Tar Products* case, plus the statute and the Regulation, provide that (regardless of the method of accounting) a dividend cannot be *income* until it is received. With that we fully agree.

§ 42 admittedly set up no new concept of "income". It taxes "amounts" accrued up to the date of death, and the Committee Reports cited in Appendix A to our opening brief confirm that the expression means amounts "of income." § 42 merely required the inclusion in a deceased taxpayer's return of *income* which had accrued up to the date of his death "regardless of the fact that the decedent may have kept his books on the cash basis." Presumably § 42 has no application at all to a decedent on the accrual basis of accounting, and in the case of a cash basis decedent (as in the instant case) does not purport to tax anything which is not the income of the decedent, *i.e.*, items which would be the income of the estate on all bases of accounting—whether cash or accrual.

Under the rule of the *Tar Products* case and *Sharp* case the estate is taxable on the dividend, since it is the

estate's income. Being the income of the estate, it cannot be the income of the decedent.

(c) The respondent has failed to meet our arguments based on accounting principles and business experience.

The respondent still claims (pp. 15-16 of his brief) that the declaration of a dividend is "generally recognized as effecting an increase in the market price of the dividend stock." He says that the mere fact that the market quotations for the stock do not go up does not mean that the market price is not increased. We are unable to follow that argument.

The respondent also argues (p. 15) that the fact that the price of stock drops on the record date by the amount of the dividend confirms the fact that it must have gone up by the amount of the dividend on the declaration date. That is an obvious *non sequitur*, since the price of the stock would gradually go up as the earnings of the corporation were accumulated, and the mere identification on the declaration date of two sticks in the shareholder's "bundle of rights" would not affect the value of the stock as such.

The respondent's brief cites (p. 26) certain accounting authorities which he claims are to the effect that a dividend should be "accrued" as soon as declared "even though a record date may be involved." None of the authorities he has cited however refer at all to a record date. They involve mainly the distinction between dividends and interest, and are uniformly to the effect that a dividend should not be accrued before it is payable.

The Commission orders (pp. 26-27) have reference to a different purpose. A corporation holds shares in another corporation generally on a long-term investment basis; and

the motive behind the rules of the S. E. C., F. P. C., I. C. C., etc. is to avoid concealment of income whose receipt is *probable* and *expected*.

(d) Nor do the miscellaneous legal authorities which the respondent has cited support his view.

Even among the decided cases, none until the present has ever indicated that a dividend accrues differently to a decedent than to anyone else. *Bach v. Rothensies*, 124 F. (2d) 306 (C. C. A. 3d), cert. den. 316 U. S. 666, cited at page 12 of the respondent's brief, is not to the contrary. That case did not present the question of when a dividend accrued. It was assumed there that the dividends in question had accrued to the trustee-holder of the stock. The case was decided about a year prior to *Tar Products Corporation v. Commissioner*, 130 F. (2d) 866 (C. C. A. 3d) which held that a dividend could not, under the express terms of the revenue laws, accrue before it was received.

The respondent's effort to support his position has led him to some curious inconsistencies. On page 25 of his brief he states that the dividends must be deemed under "principles of accrual accounting" to have accrued when they were declared, citing for that proposition the Board of Tax Appeals decision in the *Campbell* case, 6 B. T. A. 60. Then, on page 28, he tells us that the *Campbell* case has been overruled in *Koppers Co.*, 3 T. C. 62, and *American Light & Traction Co.*, 3 T. C. 1048.

So also, he agrees (p. 13) that the question of when a dividend accrues should be decided by a uniform Federal rule, and that the State law concepts of when a dividend vests in a stockholder are not controlling. However, on

pages 18-19 he cites a multitude of State Court cases with respect to when a dividend becomes a debt or vests in the shareholder, but admits that the rule is not the same in all States. Since he has already admitted that State law is not controlling, we fail to see why he has cited the State cases at all. They are not helpful to the decision of this Federal question.

Respectfully submitted,

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January 30, 1945.



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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 534

ESTATE OF HENRY W. PUTNAM, DECEASED, GUAR-
ANTY TRUST COMPANY OF NEW YORK, EXECUTOR,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 31-38) is reported at 45 B. T. A. 517. The opinion of the Circuit Court of Appeals (R. 67-72) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on August 25, 1944 (R. 72-73). The petition for a writ of certiorari was filed on October 2, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether dividends declared before the death of an individual stockholder but payable by the terms of the declaration to stockholders of record on dates which fell after his death accrued prior to the date of death within the meaning of Section 42 of the Revenue Act of 1938 so that they are includible in income for the taxable period in which fell the date of death.

STATUTE INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period.

STATEMENT

The facts were found by the Board of Tax Appeals as stipulated (R. 33). They may be summarized as follows:

Henry W. Putnam died on March 30, 1938, a resident of New York City. On the date of his death he owned shares of stock in New Jersey, Delaware, Pennsylvania, and Maine corporations. Prior to his death, each of these corporations declared cash dividends which were payable to stockholders of record on dates subsequent to the date of death and paid to the executor of Putnam's estate after his death. (R. 33-35.)

Decedent's executor filed an income tax return for the estate for the period from March 30, 1938, to December 31, 1938, and included as income therein a dividend of \$2,400 declared and paid by American Smelting & Refining Company, one of the New Jersey corporations. The executor also filed an income tax return for the decedent for the period from January 1, 1938, to March 30, 1938, and included therein the dividends, totaling \$21,651.75, declared and paid by the other corporations, two of which were organized in New Jersey, and the remainder in Delaware, Pennsylvania, and Maine.¹ (R. 35-36.)

The Commissioner determined a deficiency against the decedent for the period January 1, 1938, to March 30, 1938, on the ground in part that the dividend of \$2,400, which the estate had

¹ A schedule showing the corporations, states of incorporation, amounts of the dividends, the dates on which the dividends were declared and paid, and the record dates thereof, appears in footnote 1 of the opinion of the Circuit Court of Appeals (R. 68).

treated as its income for the later period, should be included in decedent's income for the period prior to his death (R. 24-27). However, in order to protect himself against an adverse decision, the Commissioner also determined a deficiency against the estate for the period from March 31, 1938, to December 31, 1938, on the ground in part that the dividends of \$21,651.75 should be included in the income of the estate for this period (R. 11-14). The executor appealed to the Board of Tax Appeals from both determinations (R. 5-10, 18-23). The cases were consolidated for hearing and decision (R. 32).

The Board held (R. 36-38), five members dissenting without opinion, that the dividends of the New Jersey corporations, amounting to \$20,700, constituted income accrued prior to March 30, 1938, and should be included in the decedent's income for the period January 1, 1938, to March 30, 1938, from which conclusion the executor petitioned for review (R. 52-57). The Board also held that the dividends of the Delaware, Pennsylvania, and Maine corporations, totaling \$3,351.75, accrued subsequent to the date of death and constituted income of the estate, from which conclusion the Commissioner petitioned for review (R. 41-46).

The Circuit Court of Appeals decided, Judge Learned Hand dissenting, that the dividends of all the corporations accrued on the date on which they were declared and should be included in in-

come for the period in 1938 prior to the date of death (R. 67-72).

ARGUMENT

The controlling statute is Section 42 of the Revenue Act of 1938, *supra*, p. 2, which provides for the inclusion in the income of a deceased taxpayer for the taxable period in which occurs the date of his death, of amounts which have accrued up to the date of death, if not otherwise properly includible in that period or in a prior period. In *Helvering v. Enright*, 312 U. S. 636, this Court held that the word "accrued" in Section 42 was used in a broader sense than the term "accrued" in Section 48 in connection with the accrual method of accounting and that Section 42 is to be construed in furtherance of the intent of Congress to cover into income the assets of decedents, earned during their life and unreported as income, which on a cash return would appear in the returns for the estate.² See also *Pfaff v. Commissioner*, 312 U. S. 646. The Circuit Court of Appeals decided in this case that the dividends,

² The object of Section 42, first enacted in the Revenue Act of 1934, was to require the inclusion of all amounts accrued up to the date of death regardless of the fact that the decedent may have kept his books on the cash basis. Decisions (see particularly *Nichols v. United States*, 64 C. Cls. 241; *Vanderbilt v. Commissioner*, 11 B. T. A. 291) had established that such income was not taxable to the estate when received but was a part of the corpus, and unless it was taxable in the period prior to the date of death, it escaped in-

declared prior to death but payable and paid to stockholders of record on a date subsequent to the date of death, "accrued" within the meaning of Section 42 prior to death. For the following reasons, we believe that review of its decision is not warranted.

1. The decision does not conflict with *Tar Products Corp. v. Commissioner*, 130 F. 2d 866 (C. C. A. 3d), as petitioner asserts (Pet. 5, 17-18). The question in that case was whether the Tar Products Corporation, which reported its income under the accrual basis of accounting, should report a dividend as income of the year in which it was declared or as income of the year in which it was payable and was paid. The court applied a

come tax altogether. H. Rep. No. 704, 73d Cong., 2d Sess., p. 24 (1939-1 Cum. Bull. (Part 2) 554, 572); S. Rep. No. 558, 73d Cong., 2d Sess., p. 28 (1939-1 Cum. Bull. (Part 2) 586, 608). The case of *Sharp v. Commissioner*, 91 F. 2d 802 (C. C. A. 3d), reversed on other grounds, 303 U. S. 624, takes a different view; it was there held that a dividend declared prior to a decedent's death but payable to stockholders of a record date subsequent to death and paid to his executors after his death constituted income rather than corpus and was not includible in the gross estate; the executors had reported the dividend as income of the estate and this treatment of the dividend was allowed to stand under the decision. However, the case does not constitute authority that the dividend in the case at bar would properly be reported as income for the period after death. The *Sharp* case arose under the Revenue Act of 1926 which did not contain Section 42 or its equivalent. Consequently, the issue was not presented as to whether the dividend accrued prior to death within the meaning of Section 42.

long-standing regulation³ providing that a taxable distribution by a corporation shall be included in the gross income of the distributees when the cash or other property is "unqualifiedly made subject to their demands" and held that the dividend was not includible in income at the time it was declared, because it was not then unqualifiedly subject to the demand of the stockholder.⁴ The court pointed out that the regulation makes no distinction between cash and accrual basis taxpayers, and that it therefore establishes the same criterion for both to determine when a dividend shall be included in income.⁵

In the *Tar Products* case, however, the court did not consider the question of when the dividend "accrued" within the meaning of Section 42, and in effect held that the question of accrual was irrelevant in view of the regulation. But Section

³ Article 115-1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936. The same provision appeared first as Article 1541 of Treasury Regulations 62, promulgated under the Revenue Act of 1921, and also was in force in the year in question in this case as Article 115-1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938.

⁴ This Court had already reached a similar conclusion under the same provision of an earlier regulation where the taxpayer was on the cash receipts and disbursements basis of accounting. *Avery v. Commissioner*, 292 U. S. 210.

⁵ The Tax Court has followed this decision in *American Light & Traction Co. v. Commissioner*, 3 T. C. 1048, overruling by implication its earlier contrary decision in *Campbell v. Commissioner*, 6 B. T. A. 60.

42 makes accrual the determining factor in cases such as the instant one involving a decedent's income, and it is not to be tested by ordinary principles governing the time for taxation of dividends.* Because different statutory provisions are involved there is no inconsistency in result between the *Tar Products* case and the instant one. In fact the same court which decided the *Tar Products* case approached the matter differently in a case arising under Section 42. See *Back v. Rothensies*, 124 F. 2d 306 (C. C. A. 3d), certiorari denied, 316 U. S. 666, holding that dividends had accrued at the date of death of a trust beneficiary within the meaning of Section 42, even though they had not been paid to the trust of which the decedent was a beneficiary and even though the trust agreement expressly prohibited the payment of income to beneficiaries prior to collection.

2. The judgment below is in accord with the result in all cases which have considered when a dividend "accrues" within the meaning of Section 42. See *Commissioner v. Cohen*, 121 F. 2d 348 (C. C. A. 5th); *Helvering v. McGlue's Estate*, 119 F. 2d 167 (C. C. A. 4th); *First Nat. Bank & Trust Co. v. Glenn*, 36 F. Supp. 552 (W. D. Ky). The *First Nat. Bank* case expressly holds that a divi-

* Section 115 (a) of the Revenue Act of 1938, referred to by petitioner (Pet. 13, 17), simply defines a dividend for income tax purposes. It has no relevance here, since there is no question that the amounts involved in this case were dividends.

dend accrues within the meaning of Section 42 to the stockholder at the time it is declared, regardless of the fact that the stockholder may have died before the record date. The *Cohen* case holds that the date of declaration determines the accrual date of a dividend and implies that the record date is irrelevant, since the Texas cases cited by the court (121 F. 2d at p. 349) did not give any effect to the record date. While the court concluded in the *McGlue* case under the law of New York that the record date of a dividend was merely for the convenience of the corporation, its decision (119 F. 2d at p. 175) rests on the fact that the declaration of the dividend created a debt and that the stockholder's right to the dividend accrued at that time.⁷

3. The judgment below correctly applies Section 42, as interpreted by this Court in *Helvering v. Enright*, 312 U. S. 636, in treating the dividends declared prior to the date of decedent's death as

⁷ It is agreed by the court below and the parties in this case that the question of when a dividend accrues under Section 42 requires a single test to be uniformly applied and is not to be decided by the law of the state in which the corporation declaring the dividend is formed. Cf. *Lyeth v. Hoey*, 305 U. S. 188. We believe that the court in *Helvering v. McGlue's Estate*, 119 F. 2d 167 (C. C. A. 4th), reached the correct decision but to the extent that its conclusion is based upon the theory that local law controls the result, we think it erroneous. The Board's opinion in this case (R. 36-38) is also predicated on the belief that the law of the domicile of the corporation which declared the dividend is controlling as to when a dividend accrues under Section 42.

“accrued” prior to the date of death. Even under ordinary principles of accrual accounting, income accrues and is taxable when events have occurred to fix the amount due and determine the liability to pay. *Spring City Co. v. Commissioner*, 292 U. S. 182, 184–185, rehearing denied, 292 U. S. 613; *Continental Tie & L. Co. v. United States*, 286 U. S. 290; *H. Liebes & Co. v. Commissioner*, 90 F. 2d 932 (C. C. A. 9th); cf. *United States v. Anderson*, 269 U. S. 422; *Brown v. Helvering*, 291 U. S. 193. Independently of a regulation to the contrary, it might well be held that even for ordinary accrual purposes, a dividend accrues when declared, since the resolution declaring the dividend fixes the amount due with certainty and also fixes the liability to pay. But clearly that should be the rule under Section 42 as interpreted in the *Enright* case. The declaration created a debtor-creditor relationship between the corporation and the stockholder, corporate earnings were appropriated for payment of the dividend, and the dividend was irrevocable, once the declaration was communicated to the stockholders. *Realty Inv. Co. v. Moore*, 104 F. 2d 716 (C. C. A. 6th); *Carney v. Crocker*, 94 F. 2d 914 (C. C. A. 1st); *Flynn v. Haas Bros.*, 20 F. 2d 510 (C. C. A. 9th); *United States v. Guinzburg*, 278 Fed. 363 (C. C. A. 2d); *First Nat. Bank & Trust Co. v. Glenn*, 36 F. Supp. 552 (W. D. Ky.); *Beattie v. Gedney*,

99 N. J. Eq. 207, 211-212; *McLaran v. Planing Mill Co.*, 117 Mo. App. 40; *Northwestern Marble & Tile Co. v. Carlson*, 116 Minn. 438; *Hopper v. Sage*, 112 N. Y. 530; Kehl, Corporate Dividends (1941) 184-185; 11 Fletcher, Cyclopedia of Corporations (Perm. ed., 1932), Sec. 5322. And a corporate debt is created upon declaration even though the dividend may be payable on a future date to stockholders of record on a future date; the record date is a mere convenience to the corporation to protect it in paying dividends. *Lamberth v. Commissioner*, 120 F. 2d 101, 105 (C. C. A. 9th); *Realty Inv. Co. v. Moore*, 104 F. 2d 716 (C. C. A. 6th); *Ford v. Snook*, 205 App. Div. 194, affirmed *per curiam*, 240 N. Y. 624; *Beattie v. Gedney*, 99 N. J. Eq. 207; Note, 38 Harv. L. Rev. 245 (1924). It is true that Connecticut and Massachusetts courts, in cases⁸ involving a contest over a dividend, have held that the owner of stock on the record date is entitled to the dividend rather than the owner on the date of declaration, but these cases do not hold that a dividend once declared may be rescinded. Accordingly, they do not affect the conclusion that the liability to pay has become inalterably fixed.

⁸ *Union & New Haven Trust Co. v. Watrous*, 109 Conn. 268; *Richter & Co. v. Light*, 97 Conn. 364; *Nutter v. Andrews*, 246 Mass. 224. See also dicta in *Ford v. Ford Manufacturing Co.*, 222 Ill. App. 76; *Opperman's Estate (No. 1)*, 319 Pa. 455.

Moreover, the dividends are presumed to have been declared out of profits earned by the corporation prior to the date of declaration (see *Commissioner v. Cohen*, 121 F. 2d 348, 349 (C. C. A. 5th)), during a time when the decedent was a stockholder, and if all other factors remained equal, the mere declaration of the dividend would have increased the market price for decedent's stock by the amount of the dividend. Thus from an economic and practical point of view, the dividend accrued to the decedent in the form of a material benefit and was fully earned during his lifetime. Cf. *Helvering v. Enright*, 312 U. S. 636.

The argument that the dividend does not accrue because the person who will receive it is unknown on the date of declaration is without merit. The stockholder on the date of the declaration, as the stockholder of record at that time, acquires a right to the dividend and will receive it unless the corporation is notified prior to the record date that a different stockholder owns the stock. The incumbent stockholder can fail to receive the dividend in cash only if he transfers the stock or dies prior to the payment date. But in neither case will he lose the benefit of the dividend. If he sells, he will secure a higher price for his stock because of the dividend; and if he dies, his estate takes the stock, plus the right to the dividend which it later receives in cash.

4. The question involved in this case is not likely to be of great importance in the future because of the provisions of Section 134 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798. That Section eliminates the accrual of income solely by virtue of a decedent's death and substitutes a provision whereby such items are taxed as income to the persons receiving such amounts by inheritance or survivorship. Similarly, deductions are no longer accrued to the decedent as provided in Section 43 of the Revenue Act of 1938 but may be taken by those persons who receive the income to which the deductions are related.⁹ These provisions apply in terms to taxable years commencing after December 31, 1942, but they could be made retroactive to January 1, 1934, in any case at the option of taxpayers provided they filed consents prior to January 1, 1944. See Section 134 (g) of the Revenue Act of 1942; Treasury Regulations 103, Section 19.126-4 (b), as added by T. D. 5233, 1943 Cum. Bull. 198, 208; Treasury Regulations 111, Section 29.126-4. Although Section 134 is not applicable in this case because the estate has filed no consent, its provisions have been available to other taxpayers. Consequently the question posed by this case seems largely of academic interest.

⁹ One of the purposes of Section 134 was to eliminate the hardship of pyramiding income in the period in which death occurred. See the detailed discussion of this complex provision in H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 83-88, and S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 100-105.

CONCLUSION

There is no conflict of decisions. The instant case was correctly decided in accordance with the controlling statute and decisions. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.

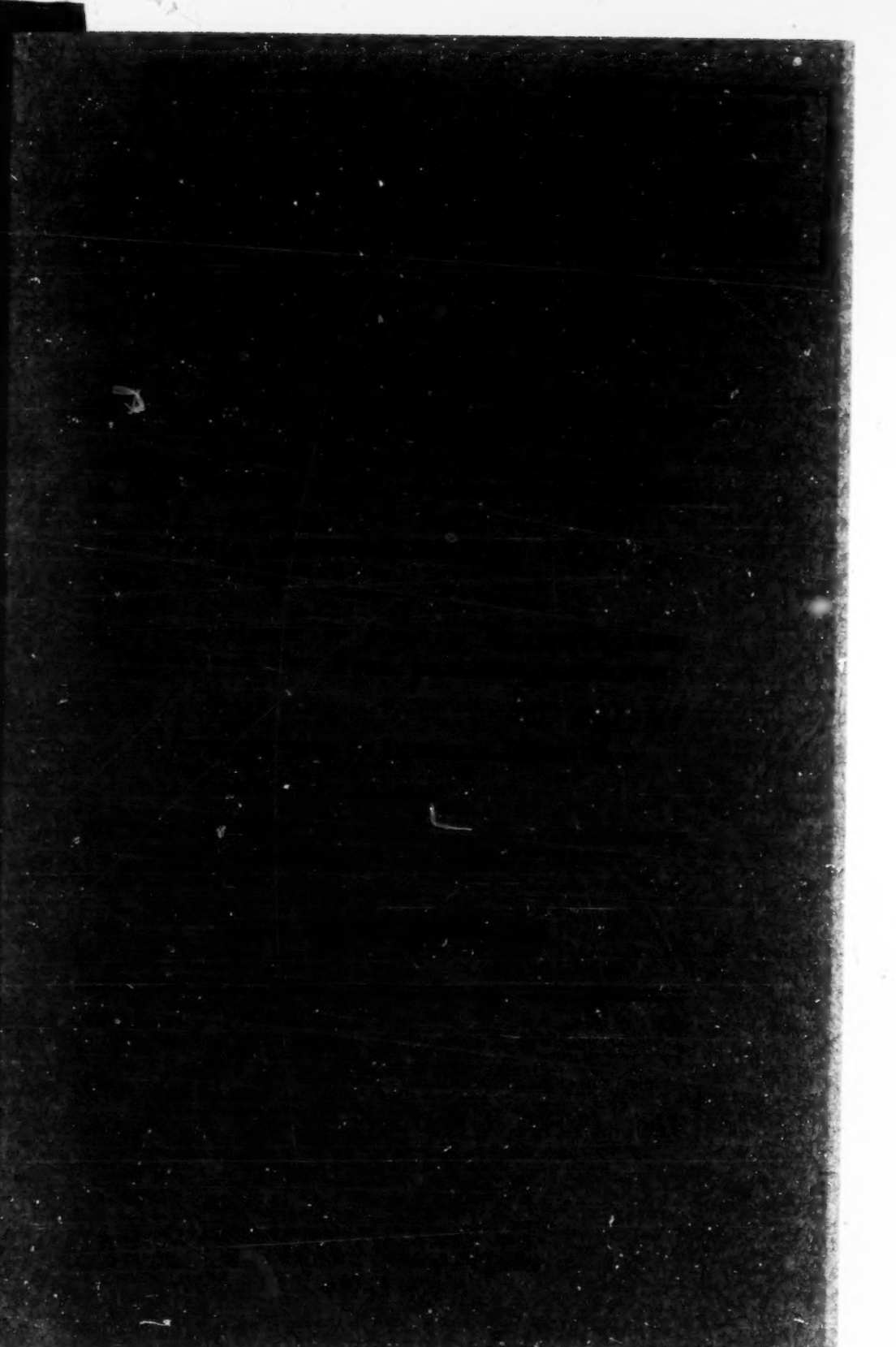
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OCTOBER 1944.





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In the Supreme Court of the United States

OCTOBER TERM, 1944

ESTATE OF HENRY W. PUTNAM, GUARANTY TRUST
COMPANY OF NEW YORK, EXECUTOR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT*

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 20-25) is reported at 45 B. T. A. 517. The opinion of the Circuit Court of Appeals (R. 40-45) is reported at 144 F. 2d 756.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on August 25, 1944 (R. 45-46). The petition for a writ of certiorari was filed on October 2, 1944, and was granted on November 13, 1944 (R. 47). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether dividends declared before the death of an individual stockholder but payable by the terms of the declaration to stockholders of record on dates which occurred after his death accrued prior to the date of death within the meaning of Section 42 of the Revenue Act of 1938 so that they are includible in income for the taxable period in which fell the date of death.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 42-1. *When included in gross income.*—Except as otherwise provided in section 42 in the case of the death of a taxpayer, gains, profits, and income are to be

included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. (See articles 41-1 to 41-3.) If a taxpayer has died there shall also be included in computing net income for the taxable period in which he died amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period, regardless of the fact that the decedent may have kept his books and made his returns on the basis of cash receipts and disbursements. * * *

STATEMENT

The facts were found by the Board of Tax Appeals as stipulated (R. 22). They may be summarized as follows:

Henry W. Putnam died on March 30, 1938, a resident of New York City. On the date of his death he owned shares of stock in certain New Jersey, Delaware, Pennsylvania, and Maine corporations. Prior to his death, each of these corporations declared cash dividends which were payable in terms to stockholders of record on dates subsequent to Putnam's death. The dividends were paid to the Guaranty Trust Company of New York as the executor of Putnam's estate after his death. (R. 22-23.) The following table shows the corporations, states of incorporation,

the amounts of the dividends, the dates on which the dividends were declared and paid, and the record dates thereof (*ibid.*):

Corporation	State of incorporation	Amount of dividends	Declaration date	Record date	Payment date
1. American Smelting & Refining Co.	New Jersey	\$2,400.00	3/1/1938	5/6/1938	5/31/1938
2. General Motors Corp.	Delaware	1,568.75	2/7/1938	4/4/1938	5/2/1938
3. United Profit Sharing Corp.	Delaware	25.00	2/24/1938	3/31/1938	4/30/1938
4. Westinghouse Air Brake Mfg. Co.	Pennsylvania	825.00	11/16/1937	3/31/1938 6/30/1938 9/30/1938	4/30/1938 7/30/1938 10/31/1938
5. Hecker Products Corp.	New Jersey	300.00	3/23/1938	4/9/1938	5/2/1938
6. Philadelphia Co.	Pennsylvania	58.00	3/18/1938	4/1/1938	4/25/1938
7. United States Smelting, Refining & Mining Co.	Maine	875.00	3/23/1938	4/1/1938	4/15/1938
8. American Can Co.	New Jersey	18,000.00	3/29/1938	4/25/1938	5/16/1938

The Guaranty Trust Company of New York, as executor, filed an income tax return for the estate for the taxable period from March 30, 1938, to December 31, 1938, and included as income therein the dividend of \$2,400 declared and paid by American Smelting & Refining Company. The executor also filed an income tax return for the decedent for the taxable period from January 1, 1938, to March 30, 1938, and included therein the dividends, totaling \$21,651.75, declared and paid by the other corporations. (R. 23-24.)


The Commissioner determined a deficiency against the decedent for the period from January 1, 1938, to March 30, 1938, on the ground in part that the dividend of \$2,400 which the estate had treated as its income for the later period, should be included in decedent's income for the period

prior to his death (R. 16-18). However, in order to protect the interests of the Government, the Commissioner also determined a deficiency against the estate for the period from March 31, 1938, to December 31, 1938, on the ground in part that the dividends of \$21,651.75, included by the executor in the decedent's income, should be included in the income of the estate for this period (R. 8-10). The executor appealed to the Board of Tax Appeals from both determinations (R. 4-7, 12-15). The cases were consolidated for hearing and decision (R. 21).

The Board held (R. 24-25), five members dissenting without opinion, that the dividends of the New Jersey corporations, amounting to \$20,700, constituted income accrued prior to March 30, 1938, and should be included in the decedent's income for the period from January 1, 1938, to March 30, 1938, from which conclusion the executor petitioned for review (R. 33-36). The Board also held that the dividends of the Delaware, Pennsylvania, and Maine corporations, totaling \$3,351.75, accrued subsequent to the date of death and constituted income of the estate, from which conclusion the Commissioner petitioned for review (R. 27-30).

The Circuit Court of Appeals decided, one judge dissenting, that the dividends of all the corporations accrued within the meaning of Section 42 of the Revenue Act of 1938 on the date

MICRO CARD

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on which they were declared and should be included in decedent's income for the period in 1938 prior to the date of death (R. 40-45).

SUMMARY OF ARGUMENT

The dividends which were declared prior to decedent's death accrued as income of the decedent prior to his death in the broad sense in which the term "accrued" is used in Section 42 of the Revenue Act of 1938. The dividends represented amounts earned on decedent's stock investments prior to his death. Upon declaration of the dividends the decedent received an immediate economic benefit. He had the right to receive the dividends so long as he retained the dividend stocks; furthermore, if he had sold the stocks, he would not have lost the benefit of the dividends, for the price he received would represent payment for both the dividends and his equity interest. Upon declaration of the dividends, the corporations became irrevocably indebted for the dividends and the decedent's right to receive them was fixed, unless by his own act he divested himself of that right. The fact that the decedent may not have had perfect legal title to the dividends prior to his death is immaterial in determining whether there has been an accrual under Section 42. Furthermore, since these dividends would properly be included as part of the gross estate, the Congressional purpose is served by treating them as income accrued

prior to death. Even if ordinary accounting principles are taken as the test, the dividends would properly be accrued as income upon the dates on which they were declared.

The regulation which specifies the time at which dividends are includible in income, whether the taxpayer reports his income on the cash or accrual basis, does not apply to the year in which a taxpayer dies, for the reason that Section 42 provides a special rule for accruing in the short period ending with death all income which has been earned at that time. Section 115 (a) of the Revenue Act of 1938 merely defines a dividend and does not purport to prescribe the time when such dividend is to be included in income; hence that Section is irrelevant to the question in this case.

ARGUMENT

THE DIVIDENDS ARE TAXABLE AS ACCRUED INCOME OF THE PERIOD ENDING WITH THE DATE OF DEATH

Section 42 of the Revenue Act of 1938 (*supra*, p. 2) provides for the inclusion in income of a deceased taxpayer for the taxable period in which falls the date of his death of amounts which have accrued up to the date of death, if not otherwise properly includible in that period or in a prior period. Thus, if the dividends involved in this case, which were declared prior to decedent's death on March 30, 1938, but which were payable to stockholders of record on dates in 1938 sub-

sequent to his death, "accrued" prior to the date of death, as the term "accrued" is used in Section 42, they are includible in income for that period.¹

The object of Section 42, which was first enacted in the Revenue Act of 1934, was to guarantee the inclusion in income of all amounts accrued up to the date of death, regardless of the fact that the decedent may have kept his books on the cash basis. At the time Section 42 was enacted, it had been determined that income of a cash basis taxpayer, which had accrued prior to death, could not be taxed as income of his estate when received but, on the contrary, the right to receive such amount was transferred to the estate upon death as a part of the corpus.² Consequently, unless such income was to be taxed in the period prior to the date of death, it escaped income tax altogether. H. Rep. No. 704, 73d Cong., 2d Sess., p. 24 (1939-1 Cum. Bull. (Part 2) 554, 572);

¹ The Commissioner determined that all the dividends were includible in the period ending with decedent's death (R. 16-18), but solely to protect the revenue in the event of an adverse decision on his first determination the Commissioner also determined a deficiency due from the estate for the period after death based on inclusion of all the dividends in income of that period (R. 8-10). Argument in the alternative will not be made here, since we believe the dividends are rightly includible as income of the period ending with the date of death.

² See, for example, *Nichols v. United States*, 64 C. Cls. 241, certiorari denied, 277 U. S. 584; and *Heller v. Commissioner*, 10 B. T. A. 53. The principle had been specifically applied to dividends declared prior to the date of death but paid to the executor after death in *Vanderbilt v. Commissioner*, 11 B. T. A. 291, and *Clark v. Commissioner*, 12 B. T. A. 425.

S. Rep. No. 558, 73d Cong., 2d Sess., p. 28 (1939-1 Cum. Bull. (Part 2) 586, 608).³ That Congress was concerned directly with dividends in enacting Section 42 is shown, not only by the fact that the Board's decisions in *Vanderbilt v. Commissioner*, 11 B. T. A. 291, and *Clark v. Commissioner*, 12 B. T. A. 425, had created the situation with respect to dividends which Section 42 was designed to remedy, but also by the fact that the conference committee report on the 1934 revenue bill refers to dividends as income which would be affected by the new provision.⁴

³ Section 134 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, amended Section 42 by eliminating the provision taxing income which has accrued prior to death to the decedent and substituting a provision whereby such items are taxed as income to the estate or the persons receiving such amounts by bequests, inheritance or survivorship. One of the purposes of Section 134 was to remove the hardship of pyramiding accrued income in the period in which death occurred. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 83-88; S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 100-105. Section 134 applies in terms to taxable years commencing after December 31, 1942, but it could be made retroactive to January 1, 1934, in any case at the option of a taxpayer, provided the estate and all those entitled to receive such amounts filed consents prior to January 1, 1944. See Section 134 (g); Treasury Regulations 103, Section 19.126-4 (b), as added by T. D. 5233, 1943 Cum. Bull. 198, 208; Treasury Regulations 111, Section 29.126-4. Section 134 does not apply to this case because the taxpayer here has not elected to take its benefits by filing the necessary consents.

⁴ H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 18 (1939-1 Cum. Bull. (Part 2) 627, 629) is in part as follows:

Amendment no. 27: Under the House bill all items of income and deductions accrued up to the date of the

In *Helvering v. Enright*, 312 U. S. 636, this Court held that the decedent's share of the profits earned up to the date of death, but not then received, of a law partnership must be included in decedent's income for the period ending with his death under Section 42, even though both decedent and the partnership were on the cash receipts and disbursements system of accounting. The Court interpreted the term "accrued" in Section 42 as having a broader scope than the term "accrued" in Section 48 relating to the accrual method of accounting. It said (pp. 644-645):

It has been frequently said, and correctly, that § 42 was aimed at putting the cash receipt taxpayer on the accrual basis. But that statement does not answer the meaning of accrual in this section. Accounts kept consistently on a basis other than cash receipts might treat accruals quite differently from a method designed to reflect the earned income of a cash receipt taxpayer. Accruals here are to be construed in furtherance of the intent of Congress to cover into income the assets of

death of the decedent were required to be reflected in the last return filed for the decedent, regardless of the fact that he may have kept his books on a cash basis. The Senate amendment makes a clarifying change to the effect that a credit of the accrued items [in computing the normal tax], such as dividends and interest on partially tax-exempt securities, will also be permitted in such cases. The House recedes.

decedents, earned during their life and unreported as income, which on a cash return, would appear in the estate returns.

See also *Pfaff v. Commissioner*, 312 U. S. 646.

Thus, Section 42 instituted a special kind of accrual basis to govern the reporting of income for the short period ending with the date of death. The method of reporting income for the years prior to that in which death occurred was not disturbed by Section 42; the individual taxpayer continued to report on a yearly basis in accordance with his ordinary method of accounting, which in the case of an individual is usually the cash basis. But in the year when death occurred, the decedent taxpayer was shifted by Section 42 to a method of accounting for the short period ending with his death, under which his return for that period was required to include all income "earned" up to the date of death which had not been previously included in income, although such income was received by his executors after his death. In the case of dividends the test prescribed by Section 42, which determines the time for their inclusion in the income of a deceased taxpayer, is radically different from the test which determines the time for taxation of dividends to a living taxpayer in an ordinary year, as will be shown.

It has uniformly been held that dividends constitute accrued income within the meaning of Sec-

tion 42 at the time they are declared, even though the dividends are in terms payable to stockholders of record on a date subsequent to the date of death. *Commissioner v. Cohen*, 121 F. 2d 348 (C. C. A. 5th); *Helvering v. McGlue's Estate*, 119 F. 2d 167 (C. C. A. 4th); *First Nat. Bank & Trust Co. v. Glenn*, 36 F. Supp. 552 (W. D. Ky.); *Estate of Ledyard v. Commissioner*, 44 B. T. A. 1056, 1065, reversed on other grounds *sub nom. Commissioner v. United States Trust Co.*, 143 F. 2d 243 (C. C. A. 2d). See also *Bach v. Rothenbies*, 124 F. 2d 306 (C. C. A. 3d), certiorari denied, 316 U. S. 666, holding that declared dividends had accrued at the date of death of a trust beneficiary within the meaning of Section 42, even though they had not been paid to the trust of which the decedent was a beneficiary and even though the trust agreement expressly prohibited the payment of income to beneficiaries prior to collection.⁵

⁵ In *Sharp v. Commissioner*, 91 F. 2d 802 (C. C. A. 3d), reversed on other grounds, 303 U. S. 624, the question was whether a dividend declared prior to a decedent's death but payable to stockholders of a record date subsequent to death and paid to his executors after death constituted corpus of the estate for estate tax purposes. In deciding that the dividend represented income to the estate, the court pointed out that the executors had reported the amount as income and that its inclusion in corpus also would result in double taxation. Its conclusion seems to have been motivated in part at least by this consideration. The case, however, is not a precedent indicating that the dividends in the instant case would properly be reported as income for the period after death, rather than for the period ending with the date of date. The

The conclusion of the court below that the dividends had accrued within the meaning of Section 42 seems manifestly correct in view of this Court's interpretation of the controlling statute that income earned prior to the date of a decedent's death, although not then received or receivable, must be attributed as accrued income of the taxable period prior to death.⁶ *Helvering v. Enright*, 312 U. S. 636. It is clear that the dividends here in question were so earned.

issue as to whether the dividend had "accrued" prior to the date of death so that it was includible in income for the period ending with the decedent's death was not involved in the *Sharp* case, and the Revenue Act of 1926 by which the case was controlled did not contain the provision of Section 42 (as pointed out *supra*, p. 8; Section 42 first appeared in the Revenue Act of 1934) with which the instant case is concerned. Although handed down after the enactment of the 1934 Act, the court's statement in the *Sharp* case that the right of the decedent to the declared dividend did not mature during his life is therefore in no sense a holding that the dividend was not accrued income within the meaning of Section 42. It should be noted that the court did recognize, however, that upon declaration the amount of the dividend was thereby taken out of the assets of the corporation and became a debt of the corporation to the stockholders to whom it was payable.

⁶The Board of Tax Appeals, following *Helvering v. McGlue's Estate*, 119 F. 2d 167 (C. C. A. 4th), decided the present case on the theory that the date on which a dividend accrues under Section 42 is determined by the date on which the corporation becomes indebted for the dividend and that this in turn depends upon the law of the state in which the corporation is domiciled (R. 24-25). Both the taxpayer and the Government argued before the Circuit Court of Appeals that the question of when a dividend accrues under Section 42 is one of federal law requiring a uniform application and that state

In the first place, dividends are presumed to have been declared out of profits earned by the corporation prior to the dates on which they were declared. *Commissioner v. Cohen*, 121 F. 2d 348, 349 (C. C. A. 5th). The presumption, of course, is grounded on the basic proposition that the directors may legally declare ordinary dividends only out of earnings. Thus dividends are regarded as earned on the date on which they are declared. 11 Fletcher, *Cyclopedia of Corporations* (Perm. ed., 1932), Sec. 5377. Since the dividends in this case were all declared prior to decedent's death, they represent income earned on decedent's stock investments prior to his death.

law concepts of when a dividend vests in the stockholder are not controlling on this question. The Circuit Court of Appeals adopted this view (R. 42). This Court indicated in *Helvering v. Enright*, 312 U. S. 636, that Section 42 is to be construed against the background of the Congressional intention in enacting it. Consequently we think there is no question that a single rule should test the accrual date of a dividend under Section 42, irrespective of the varying laws of the states of incorporation of the corporations which declared the dividends. See also *Lyeth v. Hoey*, 305 U. S. 188, 194.

We believe that the *McGlue* case was correctly decided but that the court erroneously rested its decision in part on the theory that state law controls the question of when dividends accrue under Section 42. It seems clear that the court did not rely solely on state law however, but also on the general proposition that the declaration of the dividend immediately created a corporate debt. The Board followed the *McGlue* case and applied local law in *Estate of Ledyard v. Commissioner*, 44 B. T. A. 1056, reversed on other grounds *sub nom. Commissioner v. United States Trust Co.*, 143 F. 2d 243 (C. C. A. 2d).

This fact alone would seem to be enough to attribute the income under Section 42 to the taxable period in which death occurred.

Furthermore, the declaration of a dividend, even though the dividend is payable in the future, is generally recognized as effecting an increase in the market price of the dividend stock, if other factors remain constant. See *Commissioner v. Cohen*, 121 F. 2d 348, 349 (C. C. A. 5th); *First Nat. Bank & Trust Co. v. Glenn*, 36 F. Supp. 552, 556 (W. D. Ky.); *Richter & Co. v. Light*, 97 Conn. 364; *Ford v. Ford Manufacturing Co.*, 222 Ill. App. 76. Although taxpayer disputes this fact,⁷ it seems that the declaration would tend to cause a price increase. The declaration effects a severance of the amount of the dividend from the general equity interest of the stockholders in the corporate assets. By reason of the declaration

⁷ The taxpayer argues (Br. 12-15) that the declaration of a dividend usually has no effect on the market price of stock and refers for verification to the market quotations of listed stocks. We submit that the market quotations after the declaration of a dividend in themselves do not disprove the general proposition that the declaration of a dividend tends to increase the price of the stock, for the quotations reflect the interplay of all factors, not that of the dividend declaration alone, which affect the market price of the stock. Nor does the fact that the price of stock, as listed on the stock exchanges, drops on the record date by the amount of the dividend pursuant to stock exchange rules require any different conclusion. Such fact only confirms the general understanding that the right to receive a dividend does affect the market price of stock, for otherwise the separation of the dividend from the stock would have no effect on the market price.

there has been added to the stockholders' equity interest, which is uncertain, inchoate, and indeterminate until dissolution of the corporation, a fixed right to share presently in the assets to the extent of the dividend, so long as the stock is not transferred. It is a basic fact that the right to receive money at a fixed present time is more valuable than the right to receive it at an undetermined time in the future and hence the creation by the declaration of a fixed right to receive the dividend would tend to increase the market price for the stock to reflect the dividend as well as the equity interest, unless other factors offset such increase.

But even if the declaration of a dividend is not regarded as increasing the market price of the stock, after the declaration the stockholder has two interests in place of one: an equity interest and a right to the dividend, which he will receive personally unless he sells his stock before the record date or dies before the dividends are paid. But in either of those events, he or his estate will receive the full economic value of the dividends. If he disposes of the stock before the record date, the price he receives for the stock will be consideration for both interests and consequently will reflect the dividends. If he dies before payment, his estate would take the stock, plus the right to the dividends.

Thus, in any view which may be taken, upon declaration of the dividends in this case there

accrued to the decedent an immediate economic gain which was presently realizable had he elected to sell his stocks. See *First Nat. Bank & Trust Co. v. Glenn*, 36 F. Supp. 552, 556 (W. D. Ky.). The court summarized the point in *Commissioner v. Cohen*, 121 F. 2d 348, 349 (C. C. A. 5th):

The stockholder receives the value of a dividend when it is declared, for if it is immediately paid he has his stock and his dividend, and if payment is deferred he has the value of his stock increased by the amount of the dividend upon it.

This economic benefit, which the decedent acquired upon declaration of the dividends, coupled with the fact that the dividends were earned during decedent's lifetime requires, we submit, that they be taxed as accrued income within the meaning of Section 42.

In addition, it is the general rule that a corporate resolution declaring a dividend creates a debtor-creditor relationship between the corporation and its stockholders for the amount of the dividend, even though the dividend may be payable in the future. After the dividend is declared and the declaration is communicated to the stockholders, it may not be rescinded and the liability of the corporation to pay is irrevocably fixed. See *Realty Inv. Co. v. Moore*, 104 F. 2d 716 (C. C. A. 6th); *Carney v. Crocker*, 94 F. 2d 914 (C. C. A. 1st); *Sharp v. Commissioner*, 91 F. 2d 802 (C. C. A. 3d), reversed on other grounds, 303 U. S. 624; *Alexander*

& *Alexander v. United States*, 22 F. Supp. 921, 922-923 (D. Md.); *Staats v. Biograph Co.*, 236 Fed. 454 (C. C. A. 2d); *United States v. Guinzburg*, 278 Fed. 363 (C. C. A. 2d); *Vanderbilt v. Commissioner*, 11 B. T. A. 291; 11 Fletcher, *Cyclopedia of Corporations* (Perm. ed., 1932), Sections 5322 and 5323; Kehl, *Corporate Dividends* (1941) 184-185. It is true that, where the dividend is in terms payable to stockholders of record on a future date, the precise identity of the stockholder who will receive the dividend is not known until that date arrives. It is for this reason that some courts have held, in cases involving a contest over the dividend between two claimants, that title to the dividend does not vest in any stockholder until the record date arrives and that the stockholder on that date is the owner of the dividend.* Other courts take the view that title to the dividend vests in the stockholder on the date the dividend is declared, the record date being

* *Buchanan v. National Savings & Trust Co.*, 23 F. 2d 994 (App. D. C.); *Alexander & Alexander v. United States*, 22 F. Supp. 921, 922-923 (D. Md.); *Smith v. Taecker*, 133 Cal. App. 351; *Richter & Co. v. Light*, 97 Conn. 364; *Ford v. Ford Manufacturing Co.*, 222 Ill. App. 76; *Nutter v. Andrews*, 246 Mass. 224; *Burroughs & Springs v. N. C. Railroad Co.*, 67 N. C. 376; *In re Estate of Wuichet*, 138 Ohio St. 97. Cf. *Sharp v. Commissioner*, 91 F. 2d 802 (C. C. A. 3d), reversed, 303 U. S. 624; and see dictum in *Opperman's Estate (No. 1)*, 319 Pa. 455, 464, which seems inconsistent with *Nirdlinger's Estate (No. 1)*, 327 Pa. 160, 165.

treated as a mere convenience to the corporation to protect it in paying dividends.⁹ But even those cases cited by the Tax Court (R. 24) which hold that the right to receive the dividend vests in the owner of the stock on the record date do not hold that the declaration of the dividend can thereafter

The rule of these cases, however, has been soundly criticized by writers and has been said not to represent the weight of authority but to be merely a minority exception to the general rule. See Note: When Do Dividends Vest?, 27 Georgetown L. J. 74 (1938); Note: Rights in Ordinary Corporate Dividends: Significance of Date of Closing Transfer Books, 38 Harv. L. Rev. 245 (1924); Notes on Recent Cases, 8 Minn. L. Rev. 541 (1924); Chaplin, Declaring Dividends for Future Stockholders, 13 Col. L. Rev. 401 (1913). See also *Lancaster Trust Co. v. Mason*, 151 N. C. 264, which criticizes the earlier decision in *Burroughs & Springs v. N. C. Railroad Co.*, *supra*, as being against the weight of authority, but does not overrule it, such action not being necessary for the decision.

⁹ *Lamberth v. Commissioner*, 120 F. 2d 101, 105 (C. C. A. 9th); *First Nat. Bank & Trust Co. v. Glenn*, 36 F. Supp. 552 (W. D. Ky.); *Ford v. Snook*, 205 App. Div. 194, affirmed *per curiam*, 240 N. Y. 624; *Beattie v. Gedney*, 99 N. J. Eq. 207, 212; *Western Sec. Co. v. Silver King Con. Min. Co.*, 57 Utah 88. Cf. *Realty Inv. Co. v. Moore*, 104 F. 2d 716 (C. C. A. 6th), and *United States v. Southwestern R. Co.*, 92 F. 2d 897 (C. C. A. 5th), where the record date was treated as having no significance. Cf. also *Heyn v. Fidelity Trust Co.*, 174 Md. 639, 643, and *Zell v. Safe Dep. & Trust Co.*, 173 Md. 518. Whether a subsequent statute has altered the rule of *Ford v. Snook*, *supra*, in New York is not finally decided. Two surrogates have taken opposite views on the matter. Cf. *In re Depew's Estate*, 179 Misc. 1074, with *Matter of Bashford*, 178 Misc. 951.

be revoked,¹⁰ and hence do not affect the proposition that the liability of the corporation to pay has become inalterably fixed. Furthermore, in those cases where a stockholder has sold his stock after the dividend was declared but before the record date, the courts have emphasized the fact that the vendor must have received a price equivalent to his equity interest plus the dividend, and therefore should not be permitted to recover doubly. See, *e. g.*, *Richter & Co. v. Light*, 97 Conn. 364, 369, 371-372. Clearly if it were not the law that a dividend was irrevocable once declared, the owner of the stock on the date of declaration would not on a subsequent sale be assumed to have secured a price for the stock reflecting the declared dividend.

The precise time when legal title to the dividends may have vested in decedent or his executor is irrelevant to the question of accrual under Section 42. This Court has made that point clear in *Helvering v. Enright*, 312 U. S. 636, where it was held that the interest of Enright in the unfinished work of his law partnership had accrued at the date of his death, although it is obvious that the right to receive the amount from the clients had not vested in the partnership or

¹⁰ *Alexander & Alexander v. United States*, 22 F. Supp. 921, 923 (D. Md.) expressly holds that a declared dividend cannot be revoked, even though it is payable to stockholders of record of a future date.

Enright at the time of his death. See *supra*, pp. 10-11. Moreover, this is not a case where the dividends are claimed by two persons so that the legal title to the dividends is directly involved. The decedent owned the stocks until his death and consequently he also owned the *prima facie* right, which could only be defeated by a voluntary transfer of the stocks, to receive the declared dividends. At his death these rights passed to his estate. The precise time at which this *prima facie* right to the dividends became a vested right is immaterial in considering when the dividends were earned and accrued.

Since upon the declaration of the dividends in this case the eight corporations became irrevocably committed to pay the dividends, and to the decedent unless he disposed of the stocks prior to the record date, the dividends had accrued prior to the date of decedent's death. This conclusion as to accrual is inescapable when there are added the facts that the dividends had been earned when they were declared and that the decedent at the time received a clear economic benefit.

The dissenting judge below rested his dissent upon the fact that it was not certain upon the dates of declaration that the decedent would receive the dividends (R. 44-45). He stated that the doctrine that the dividends had accrued as income prior to death might not work unfairly when applied between a decedent and his ex-

ecutors, but that when applied to sales it would lead to preposterous results because the dividend would be doubly taxed, once as a dividend and once as a part of the gain upon sale (R. 44). The fallacy of this statement is that there would be no occasion to apply Section 42 if the decedent had sold his stock prior to his death. As has already been shown, Section 42 has a very limited scope, confined entirely to the short period, preceding death, of the year in which the taxpayer dies. It applies only when the decedent's estate has or will in fact receive after his death amounts which as income are attributable to the period before death by reason of having been earned then. If a decedent disposes of his stock and declared dividends prior to his death, his estate will not receive the dividends after his death. Therefore the question whether they had accrued prior to death could not arise. Consequently, the only income which would be taxed in the period prior to death, if the stocks were sold before death, would be the gain on the sale of the stocks, which gain would of course reflect the dividend.

A further important consideration is that the decision of the court below gives effect to the Congressional purpose underlying Section 42 in treating as accrued income items which pass to the executor as a part of the gross estate. Article 13 of Treasury Regulations 80 (1937 Ed.), pertaining to the estate tax, provides as follows:

Outstanding dividends and accrued interest should be included in the gross estate. Dividends on either common or preferred stock should be separately listed on the return if declared prior to the applicable valuation date, and not reflected in the market value of the stock on that date. Thus, dividends both declared and payable to holders of record on a date prior to the valuation date, should be separately included, provided the stock is valued "ex dividend" on the valuation date.

Example: A 5 per cent dividend upon stock is declared March 1, payable on April 1, to stockholders of record on March 15. If the applicable valuation date is March 10, and the market value on that day was 90, the value to be returned for both stock and dividend is 90, the dividend being reflected in the market value of the stock. If the applicable valuation date is March 20, the dividend is not reflected in the market value, and must be returned in addition to the market value of the stock on March 20.¹¹

¹¹ This provision was amended by T. D. 5047, 1941-1 Cum. Bull. 425, to read as follows (p. 426) :

* * * dividends declared to stockholders of record on or before the date of the decedent's death and not collected at such date constitute part of the gross estate.

This amendment is not applicable to this decedent since he died on March 30, 1938. The amended regulation furthermore is not contrary to our position that dividends declared prior to death but payable to record holders of a date after death is a part of the gross estate, since the Treasury Deci-

Thus, the dividends in this case properly constitute a part of the gross estate, either as part of the value of the stocks if that value included the dividends, or as separately listed dividends. They could not properly be treated as income of the estate when received, since the receipt of the dividends in cash was merely a conversion into money of one of the assets of the estate. See *Vanderbilt v. Commissioner*, 11 B. T. A. 291. *Sharp v. Commissioner*, 91 F. 2d 802 (C. C. A. 3d), reversed on other grounds, 303 U. S. 624, is authority for the proposition that dividends cannot be both a part of the corpus of the estate and income to the estate. We believe, however, that the *Sharp* decision is erroneous in holding that the dividends there were income rather than a part of the gross estate, since it is contrary to the regulation and is out of harmony with the *Vanderbilt* case and *Nichols v. United States*, 64 C. Cls. 241, certiorari denied, 277 U. S. 584, with which Section 42 was intended to be synchronized. See pp. 8-9, *supra*. The discussion of Section 42 in the Committee Reports (H. Rep. No. 2333, 77th Cong., 2d Sess., p. 84; S. Rep. No. 1631, 77th Cong., 2d Sess., p. 101) upon the amendments made by Section 134 of the Revenue Act of 1942, c. 619, 56 Stat. 798, further indicates that declared dividends are well within the scope of Section 42 (see fn. 3, *supra*, p. 9).

sion is silent on the subject, and in fact the Bureau practice has continued unchanged after the amendment.

The foregoing discussion demonstrates, we think, that the dividends in this case had accrued within the meaning of Section 42 as income of the decedent prior to his death. As has been pointed out, the term "accrued" as used in Section 42 is not restricted to cases of accrued income in the ordinary accounting sense, but even if principles of accrual accounting are applied as the test, the conclusion follows that the dividends in this case accrued when they were declared (see *Campbell v. Commissioner*, 6 B. T. A. 60). The directors' resolutions fixed the amounts of the dividends with certainty and the liability of the corporations to pay them. It is true that when the dividends were declared, the decedent's right to receive them as such in cash was dependent upon his holding the stocks until the record date, but the decedent himself controlled the right to receive; it was in his power to hold the stock until the record date and receive the dividend or to sell it and receive its value. Had he sold his stock before the record date the sale would have carried with it the right to receive the dividends. But we submit that any creditor has the right to sell or assign his claim, yet the mere possibility of its being sold or assigned would not defer accrual of the gain as income. Hence, we think that the decedent had a right to receive the dividends at the time they were declared such as would justify their accrual, if ordinary principles of accrual accounting were to be applied.

(See *Spring City Co. v. Commissioner*, 292 U. S. 182, 184-185, rehearing denied, 292 U. S. 613; *Continental Tie & L. Co. v. United States*, 286 U. S. 290; *H. Liebes & Co. v. Commissioner*, 90 F. 2d 932 (C. C. A. 9th); cf. *United States v. Anderson*, 269 U. S. 422; *Brown v. Helvering*, 291 U. S. 193). This conclusion finds strong support in the leading accounting authorities. Because an irrevocable corporate debt is created upon declaration of a dividend, accounting theory prescribes that the declared dividend be *instantly* listed as a liability of the corporation declaring it and as an asset and income of the stockholder at the date of declaration, even though a record date may be involved. Kohler and Morrison, *Principles of Accounting* (2d Ed., 1931) 274; Esquerre, *Applied Theory of Accounts* (1914) 30, 301, 362; Paton, *Accountants' Handbook* (2d Ed., 1934) 278, 1008; Paton, *Essentials of Accounting* (1938) 324, 325; Bell, *Auditing* (1924) 147, 274. This is also the rule recommended in uniform accounting systems by federal regulatory agencies. See S. E. C., *Uniform System of Accounts for Public Utility Holding Companies* (1936) 14, Acc't. No. 116; F. C. C., *Uniform Systems of Accounts for Telephone Companies* (1935) 32, Acc't. No. 121; F. P. C., *Uniform System of Accounts Prescribed for Public Utilities and Licenses* (1936) 23, Acc't. No. 128; I. C. C., *Uniform System of Accounts for Electric Rail-*

ways (1914) 82, Acc't. No. 412; S. E. C., Instruction Book for Form A-2 for Corporations 34, item 24.

The case of *Tar Products Corp. v. Commissioner*, 130 F. 2d 866 (C. C. A. 3d), relied on by taxpayer (Br. 9), does not support taxpayer on the proposition that the dividends in this case did not accrue until after decedent's death. There was no issue in that case as to when a dividend "accrues," either under ordinary accrual concepts or under Section 42. The question was whether the Tar Products Corporation, which reported its income under the accrual basis of accounting, should report a dividend as income of the year in which it was declared or as income of the year in which it was "received." The applicable regulation¹² provided that—

A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands.

¹² Article 115-1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936. Article 42-3 is to the same effect. This language was originally incorporated in Section 201 (e) of the Revenue Act of 1921 but was omitted in subsequent Revenue Acts. The provision was also contained in Articles 53 and 1541 of Treasury Regulations 62, promulgated under the Revenue Act of 1921. It was continued in subsequent regulations and was in effect in the year 1938 as Articles 115-1 and 42-3 of Treasury Regulations 101, promulgated under the Revenue Act of 1938.

The court held under this regulation that the dividend was includible in income in the year in which it was received by the taxpayer because it was not unqualifiedly subject to the demand of the stockholder before that time.¹³ The court pointed out that the regulation makes no distinction between cash and accrual basis taxpayers and establishes the same criterion for both to determine when a dividend shall be included in income. Thus the court did not decide the question of when a dividend accrues as income even under ordinary accounting principles.

The regulation which the court construed in the *Tar Products* case does not apply to a Section 42 case. The regulation may direct that the time for taxing dividends to an accrual basis taxpayer is the time when the dividend is received in years where a taxpayer is alive to receive the dividend, but Section 42 makes an exception to this rule for the year in which the taxpayer dies. The

¹³ In *Avery v. Commissioner*, 292 U. S. 210, this Court held that a dividend became unqualifiedly subject to the demand of a cash basis taxpayer when the check in payment of the dividend was received. Cf. also *Mason v. Routzahn*, 275 U. S. 175.

The *Tar Products* case has been followed by the Tax Court in *Koppers Co. v. Commissioner*, 3 T. C. 62, petition for review pending on other issues (C. C. A. 3d), and *American Light & Traction Co. v. Commissioner*, 3 T. C. 1048. The Tax Court has therefore overruled by implication its earlier contrary decision in *Campbell v. Commissioner*, 6 B. T. A. 60 (see p. 25, *supra*).

inquiry as to the time when a dividend "accrues" to a living taxpayer who reports his income on the accrual basis of accounting is foreclosed by reason of the regulation, which in effect removes dividends from the category of accruable items and substitutes a "receipt" test, but the inquiry as to the time dividends accrued to a deceased taxpayer is necessitated by Section 42, because that Section makes accrual the determining factor. And since the regulation dates from 1921 and thus preceded Section 42 by many years, the regulation could not have been intended as an interpretation of the word "accrued" as used in Section 42. Moreover, as has already been pointed out (*supra*, pp. 9, 24), the Committee Reports show that the term "accrued" was used in Section 42 by Congress, with dividends specifically in mind, in a specialized and broad sense, which is quite different from the long-standing rule of the regulation. The only possible conclusion is that Section 42 and the regulation are mutually exclusive in their respective fields.

Nor is Section 115 (a) of the Revenue Act of 1938, upon which taxpayer relies (Br. 9-10), relevant to the question involved in this case. That Section is as follows:

(a) *Definition of Dividend.*—The term "dividend" when used in this title * * * means any distribution made by a corporation to its shareholders, whether in money

or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year * * *.

The taxpayer argues that the decedent did not have income from dividends prior to his death on the theory that the amounts declared became dividends within this definition only when the distribution was made to the stockholders. We submit that this contention is an unreasonable interpretation of that Section, which defines a dividend by specifying the sources from which a corporate distribution must be paid to result in a dividend. The word "made" in the statute does not refer to the time at which any distribution will become a dividend, but on the contrary refers to the source of the distribution; that is, a dividend is a distribution made out of accumulated earnings or out of earnings of the taxable year. We submit there is no merit to the contention that under Section 115 (a) there can be no accrued income from dividends until the distribution has been "made."

If in the special circumstances suggested by taxpayer (Br. 11), an item of corporate distribution would be treated differently for a decedent taxpayer, the result would not be unique in recognizing that death may capitalize certain items. Cf. *Bull v. United States*, 295 U. S. 247, 256-257.

The Court will observe that the \$825 dividend of Westinghouse Air Brake Company was declared on November 16, 1937, payable in three installments to stockholders of record on March 31, 1938, June 30, 1938, and September 30, 1938 (R. 23). It might seem that this particular dividend should not be treated as having accrued in the period from January 1, 1938, to March 30, 1938, because it was not declared during that period. But analysis refutes this. During the year 1937 when the Westinghouse dividend was declared, the decedent reported his income on the cash basis. Hence he was not required to report the declared dividend as income of 1937, because it was not then unqualifiedly subject to his demand. However, upon his death on March 30, 1938, the decedent was shifted by Section 42 for the first three months of that year to the special accrual plan of reporting income prescribed therein. Under this Section, his executor was required to report, as decedent's income of the short period, earned income which was not properly includible in a prior period. Since this dividend was not properly includible in 1937 by the decedent, it is to be included in the return for the short period preceding death because it accrued prior to death. Cf. *Estate of Lambert v. Commissioner*, 40 B. T. A. 802, 805-806.

CONCLUSION

For the foregoing reasons, the judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted.

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JANUARY 1945.

SUPREME COURT OF THE UNITED STATES.

No. 534.—OCTOBER TERM, 1944.

Estate of Henry W. Putnam; Guar- anty Trust Company of New York, Executor, Petitioner, vs. Commissioner of Internal Revenue.	} On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.
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[March 26, 1945.]

Mr. Justice REED delivered the opinion of the Court.

This case brings here for review a judgment which applies Section 42, Revenue Act of 1938,¹ so as to "accrue" corporate dividends on the date of their declaration rather than the later record or payment dates. The result is that the dividends are taxable as income to a decedent taxpayer instead of to his estate.

Certiorari was granted² because of a conflict in conclusion between *Tar Products v. Commissioner*, 130 F. 2d 866, and this case as to the date of accrual of corporate dividends. The resolution of this conflict is complicated by further conflicts between the decision below and those in other circuits as to whether the governing rule is to be drawn from federal or state law. *Helvering v. McGlue's Estate*, 119 F. 2d 167, 171; *Commissioner v. Cohen*, 121 F. 2d 348, 349.

The decedent, Henry W. Putnam, died on March 30, 1938. Prior to his death several corporations in which he owned stock declared dividends which by the resolutions were payable and were paid to stockholders of record on dates which were subsequent to his death. Each of these dividends, aggregating in all \$24,051.75, was held by the Commissioner to constitute income to

¹ 52 Stat. 447, 473, Sec. 42:

"The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period."

² 323 U. S. —. Judicial Code, Section 240(a), as amended.

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the decedent under the provisions of Section 42. The Board of Tax Appeals decided that the time of accrual depends upon the varying state decisions as to when a corporate debt arises upon a declaration of dividend with a provision for its payment to stockholders of record on some future date. 45 B. T. A. 517. This resulted in an agreement in part with the Commissioner's determination.

The Circuit Court of Appeals was of the view that federal law controlled the disposition of the controversy and that the dividend accrued on its declaration. *Commissioner v. Guaranty Trust Co., etc.*, 144 F. 2d 756.

We think the federal law controls. A federal revenue act applicable throughout the nation fixes liability on the decedent taxpayer under Section 42 if the dividend is "accrued." The meaning of that word in this section should be uniform unless Congress has shown an intention to permit its meaning to be varied by state law. *Burnet v. Harmel*, 287 U. S. 103, 110; *Palmer v. Bender*, 287 U. S. 551, 555; *United States v. Pelzer*, 312 U. S. 399, 402-3. Section 42 lays down the test of accrual for the taxation of a decedent's income and the definition of the meaning and extent of that test is a federal responsibility. The present problem is closely akin to that resolved in *Lyeth v. Hoey*, 305 U. S. 188, 193. In that case an heir received a sum in settlement of litigation over a will. Its taxability as income under the federal statute depended upon the meaning of the statutory exemption "acquired by inheritance." The law of the testator's domicile held sums paid as will compromises were not inheritances. Acting on the principle that in the interest of uniformity exemptions under federal statutes should be determined by federal courts, we reached a contrary federal rule. The same principle leads to our conclusion in this case.³

³ The Government calls attention to the conflict in state decisions as to the event which vests title according to state law to a corporate dividend. Some specify the declaration and some compliance with the requirement of being a stockholder of record on a subsequent date.

Declaration date: *Ford v. Snook*, 205 App. Div. 194, 196, aff'd 240 N. Y. 624; *Beattie v. Gedney*, 99 N. J. Eq. 207; *Western Sec. Co. v. Silver King Con. Min. Co.*, 57 Utah 88, 113; 27 Georgetown L. J. 74; 35 Harv. L. Rev. 245.

Record date: *Smith v. Taecker*, 133 Cal. App. 351; *Richter & Co. v. Light*, 97 Conn. 364; *Ford v. Ford Manufacturing Co.*, 222 Ill. App. 76, 84; *Nutter v. Andrews*, 246 Mass. 224.

Accrual under Section 42, however, is not dependent upon these varying concepts of when dividends vest. Despite possible difference between state

We recently examined the Congressional purpose in the enactment of Section 42. *Helvering v. Enright*, 312 U. S. 636. That purpose was to cover into income the "accruals" theretofore unreported as income of a decedent taxpayer who reported on a cash basis. By "accrual" the income so accrued became subject to income tax as decedent's income. These "accruals" had theretofore escaped taxation as the income of decedent, because no cash was received during decedent's life. Moreover, such payments were held not to be the income of decedent's estate on the theory that the "accrual" was a part of the corpus of the estate at death and therefore the estate's subsequent receipt of the "accruals" as cash was not income to the estate. *Helvering v. Enright*, *supra*, p. 639. In the instant case there is no avoidance of income taxes such as Section 42 was designed to prevent. If the dividend does not "accrue" to decedent on the date of declaration so as to be taxable as income to him, it will appear as an item of income in the income tax return of the estate or of the stockholder who owns the stock on the record date.⁴ Taxwise, it may be important upon whom the tax falls as the sum assessed may vary according to the tax bracket of the taxpayer. This re-

and federal income taxation of dividend items, the presumed Congressional purpose to have the national revenue acts uniformly administered leads to a federal interpretation of accruals under Section 42.

Such inconsistency would not occur if the federal accrual date under Section 42 is held eventually to be the same for taxpayers on the accrued and cash basis. Cf. *Avery v. Commissioner*, 292 U. S. 210; *Tar Products v. Commissioner*, 130 F. 2d 866.

⁴ Respondent argues for the judgment below on the ground that the dividends could not properly be treated as income of the estate when received, since the receipt of the dividends in cash by the estate was merely a conversion into money of one of the assets of the estate, citing *Vanderbilt v. Commissioner*, 11 B. T. A. 291; *Nichols v. United States*, 64 Ct. Cl. 241; 80 Treas. Reg., Art. 13. The truth or error of this position depends upon whether those dividends are income, by virtue of the accrual provision of Section 42, to the decedent. If they are income to the decedent, they cannot be income also to the estate. If they are not income to the decedent, they are income to the estate. The *Vanderbilt* and *Nichols* cases were apparently decided on the theory that the items in controversy constituted income to the decedent and assets of the estate for estate tax purposes and therefore could not later be income to the estate. The regulation does not purport to direct the return as corpus of the estate of dividends declared but with a record date subsequent to the stockholder's death. Neither do the present regulations. 105 Treas. Reg., Sec. 81.13; cf. *United States v. Phellis*, 257 U. S. 156, 171.

Congress has modified Section 42 by an amendment which is inapplicable to this case. Revenue Act of 1942, Sec. 134, 56 Stat. 798, 830; H. Rep. No. 2333, 77th Cong., 2d Sess., Sec. 125, p. 83; S. Rep. 1631, 77th Cong., 2d Sess., Sec. 135, p. 100.

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sult, however, is apart from the purpose of Congress in enacting Section 42 and is not significant in the interpretation of the section.⁵

We assume that decedent was a taxpayer on the cash receipts basis. Compare 144 F. 2d 756, 757.⁶ Our inquiry leads us only to a decision as to whether a dividend accrues as income on its declaration with a subsequent record date, not to whether it accrues on its record date or its payment date. A declaration of a dividend to stockholders of record on the date of the resolution but payable in the future is not involved. This Court has suggested that a tax be deemed to accrue as a charge against a taxpayer when events "occur which fix the amount of the tax and determine the liability of the taxpayer to pay it." *United States v. Anderson*, 269 U. S. 422, 441. It has said also that accrual imports "that it is the right to receive and not the actual receipt that determines the inclusion of the amount in gross income." *Spring City Co. v. Commissioner*, 292 U. S. 182, 184. The declaration of the dividends here in question fixes their amount but does not determine the distributee. He cannot be known with certainty until the record date. Nor does the stockholder have the right to receive payment upon the declaration. The words of the corporate resolution which arranges for the payment from the

⁵ A reference to dividends appears in the legislative history but casts no light on the problem of the event which accrues a corporate dividend. See H. R. 7835, 73rd Cong., 2d Sess., printed with Senate amendments, March 28 (Calendar day, April 13), 1934; I. R. B. (O. B. 1939-1 (Part 2), p. 629, Amendment 27; Section 43, Revenue Act, 1934, 48 Stat. 694; Section 43, Revenue Act of 1938, 52 Stat. 473.

⁶ Therefore the construction of accrued according to the taxpayer's method of accounting, which is directed in Sec. 48(c), 52 Stat. 476, is not of use. *Helvering v. Enright*, 312 U. S. 636, 644. *Avery v. Commissioner*, 292 U. S. 210, holds that dividends of a living taxpayer on the cash basis would not become his income on mere declaration but only when "received," that is, unqualifiedly made subject to the stockholder's demand as by check. "Received" in the section there under consideration was the word designating taxability as income of sums actually or constructively collected, including dividends, as it is in the section of the statute here involved. This rule has been continuously applied.

See *Mason v. Routzahn*, 275 U. S. 175, 178; 65 Treas. Reg., Art. 1541; 101 Treas. Reg., Art. 42-3; 111 Treas. Reg., Sec. 29.42-3; 53 Harv. L. Rev. 853; 2 Mertens, Federal Income Taxation, 17.

See *Tar Products v. Commissioner*, 130 F. 2d 866, for an instance of the application of this rule to a taxpayer on the accrual basis. Compare 94 Treas. Reg., Art. 115-1 and 22(a)(1) for appraisal of position of those regulations as to date when dividends are received by a taxpayer. *American Light & Traction Co.*, 3 T. C. 1048.

stock record of a certain day determines the earliest time for possible receipt. '

Under the income tax acts no stockholder has a separate and divisible taxable interest in the assets of a corporation even though those assets have been increased by earnings. Earnings, before declaration of dividends, while increasing the value of his stock, have never been treated as an event to mark taxable income to the stockholder. Mere declaration of a dividend does not alter the stockholder's interest in the corporate assets. If no other factors were involved in value except earnings and dividends, the value of the stock would advance *pari passu* with earnings and the declaration of a dividend with a subsequent record date for payment would not affect the stock's value. *United States v. Phellis*, 257 U. S. 156, 171. See Schabacker, *Stock Market*, 353. The stockholder can acquire no interest in a dividend, amounting to an accrual under Section 42, before the amount of the dividend and the distributee is determined.

In applying to the present dividends our description of accruals under Section 42 as "assets of decedents, earned during their life and unreported as income, which on a cash return, would appear in the estate returns," the Court of Appeals may have treated the words "earned during" the decedent's life as though they included, prior to a declaration of dividends, the proportionate part of corporate earnings attributable to decedent's stock. If so, it is a more extended meaning than was intended since stock does not earn an identifiable separate taxable share of corporate profits for its owner before the corporation makes those profits available to the stockholder. It is not the earnings of a corporation but the separation of those earnings by a completed dividend which assigns a part of those earnings to a stockholder. The price a stockholder would receive on a stock sale after declaration and before the record date would reflect corporate earnings but would not reflect the declaration or non-declaration of a dividend. As the same value would be in the stock with or without the declaration, the price would be the same. Only an ex-dividend sale would affect price.

For the earnings of a corporation to pass into the earnings of its stockholder, so as to be subject to accrual to the stockholder under Section 42, something more than a declaration of dividends

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with a subsequent record date to identify the distributee is required. Such a declaration leaves the identity of the recipient at large. Such uncertainty destroys any conception of accrued as involving a right to receive or an obligation to pay, elements which we think are essential for accruals under our decisions.⁸

Reversed.

⁸ This accords with the original holding of the Board of Tax Appeals on this question in *Estate of G. Percy McGlue*, 41 B. T. A. 1186, 1193. After that case was reversed on the law of New York, *Helvering v. McGlue*, 119 F. 2d 167, the Board followed the Circuit Court decision. *Estate of Lewis Cass Ledyard, Jr.*, 44 B. T. A. 1056, 1065. Recently the Tax Court has held that a taxpayer on the accrual basis should account for a dividend when received. *American Light & Traction Co. v. Commissioner*, 3 T. C. 1048.